No. 96-342

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# Supreme Court of the United States

OCTOBER TERM, 1995

**IN THE MATTER OF WABASH VALLEY POWER ASSOCIATION, INC.**

**THE UNITED STATES OF AMERICA, ON BEHALF OF THE RURAL ELECTRIFICATION ADMINISTRATION,**

*Petitioner,*

**WABASH VALLEY POWER ASSOCIATION, INC.,**

*Respondent.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit**

## BRIEF IN OPPOSITION OF RESPONDENT WABASH VALLEY POWER ASSOCIATION, INC.

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## THE QUESTION ACTUALLY PRESENTED

The Rural Electrification Administration ("REA") presents only one question for this Court's consideration: Whether the Court of Appeals created an exception to the "absolute priority rule" of 11 U.S.C. § 1129(b)(2)(B)(ii) for a not-for-profit cooperative whose members continue to elect its directors even though its unsecured creditors have not been paid in full. This question is not properly raised here by the REA because the Seventh Circuit recognized no such exception. Instead the Court of Appeals applied the absolute priority rule to the specific and unique facts found by the Bankruptcy Court, reviewed and accepted by the District Court and the Seventh Circuit and binding on REA here, and concluded, primarily as a factual matter, that the rule was not violated. The Seventh Circuit did not purport to create an "exception" to the absolute priority rule as REA asserts, but instead explained why the rule had not been violated in this particular instance. Therefore, the only question that properly could be presented to this Court is:

> Did the Court of Appeals correctly find—based on the detailed facts found by the Bankruptcy Court and accepted by the District Court and settled legal principles previously determined by the Indiana Supreme Court and the Seventh Circuit—that Wabash Valley's Reorganization Plan does not violate the absolute priority rule because as a state-regulated, not-for-profit public utility, Wabash Valley's Members have no equity interest in Wabash Valley, cannot receive any profits or dividends from Wabash Valley's continuing operations, have no claim to any of Wabash Valley's property even if it were liquidated, and retain the right to elect its board of directors because of provisions of their power supply contracts with Wabash Valley?

## PARTIES TO THE PROCEEDING

REA's petition includes a list of the parties to this proceeding.

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## BRIEF IN OPPOSITION OF RESPONDENT WABASH VALLEY POWER ASSOCIATION, INC.

Respondent Wabash Valley Power Association, Inc. ("Wabash Valley") opposes the petition filed by the Rural Electrification Administration ("REA"). REA fails to identify any substantive conflict between the decision of the Seventh Circuit here and this Court's decision in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), or the Tenth Circuit's decision in *Unruh v. Rushville State Bank*, 987 F.2d 1506 (10th Cir. 1993), nor does the petition raise any important question of federal law requiring resolution by this Court. REA's petition should be denied because:

1. The Seventh Circuit's decision is extremely fact-specific and is based upon facts unique to Wabash Valley. REA consistently ignores the extensive findings of fact by the Bankruptcy Court regarding the Wabash Valley Plan that were affirmed by both the District Court and the Seventh Circuit. Those factual findings, which are binding on REA here, contradict every material assertion that REA makes regarding the Wabash Valley Plan.

2. REA mischaracterizes the Seventh Circuit's decision as creating an exception to the absolute priority rule for all not-for-profit cooperatives. The Seventh Circuit created no such exception. The Seventh Circuit correctly decided that based upon the unique legal and contractual relationship between Wabash Valley and its Members and Wabash Valley's status as a state-regulated, not-for-profit public utility, the Wabash Valley Reorganization Plan does not violate the absolute priority rule. The Members have no equity interest in Wabash Valley, and cannot profit at REA's expense now or in the future.

Wabash Valley's situation is clearly distinguishable from the for-profit farmers in *Ahlers* and *Unruh* who retained the "right to the future profits of their farms," *Unruh*, 987 F.2d at 1508, as well as their interests in the land that could be liquidated at a profit in the future. The Members' right to elect Wabash Valley's directors results from the power supply contracts that Wabash Valley assumes as part of its Plan, not because of their pre-petition interest in Wabash Valley.

3. The outcome below was determined largely by previous decisions by the Indiana Supreme Court and the Seventh Circuit, to which REA and Wabash Valley were parties and which REA never requested this Court to review, holding that Wabash Valley cannot raise rates to repay REA's loan guarantees because Marble Hill was never used and useful, and that REA cannot preempt state rate regulation to impose rate increases to repay any part of its Marble Hill loan guarantees.

4. The Seventh Circuit properly recognized that the Wabash Valley Plan "makes economic sense" because it maximizes the recovery for REA and other creditors. REA abandoned its own Plan before the Seventh Circuit, arguing instead that Wabash Valley must be liquidated even though as a result of REA's *de facto* auction of Wabash Valley, its Members are paying more for Wabash Valley than anyone else offered and the creditors will receive $457 million under the Wabash Valley Plan—including $431 million for REA (65% of its pre-petition claim)—or $282 million more than the $175 million they would realize through liquidation of Wabash Valley's physical assets, the only alternative now offered by REA.

5. The Seventh Circuit properly rejected REA's unsupported assertions of harm to REA's lending program. The

Seventh Circuit correctly concluded that REA's loan guarantees to Wabash Valley are governed by idiosyncratic legal and factual circumstances that cannot adversely affect REA's relationships with other borrowers.

6. The Seventh Circuit also correctly dismissed REA's claim of absolute power to veto Wabash Valley's Plan as inconsistent with the express language of the Bankruptcy Code and contrary to the clear public policy that Congress incorporated in Chapter 11 to promote the rehabilitation of debtors, especially where creditors like REA ignore economic reality and seek to liquidate the debtor regardless of the cost to itself and others.

## OPINIONS BELOW

In addition to the opinions in REA's Appendix, there are three previous decisions (copies of which are included in Appendices A, B and C), to which REA and Wabash Valley were parties and which REA never asked this Court to review, that are largely determinative of the arguments REA makes in its petition. The opinion of the Indiana Supreme Court in Wabash Valley's Marble Hill rate case denying any rate increase to repay Marble Hill indebtedness because the project was never "used and useful" in providing public utility service is reported at 552 N.E.2d 23 (App. A). The two previous opinions by the United States Court of Appeals for the Seventh Circuit rejecting REA's attempts to preempt state regulation of Wabash Valley's rates are reported at 903 F.2d 445 (App. B) and 988 F.2d 1480 (App. C).

## STATEMENT OF THE CASE

REA's "Statement" misstates or ignores numerous material findings of fact by the Bankruptcy Court that were reviewed and accepted by both the District Court and the Seventh Circuit. These findings demonstrate that review by this Court is unwarranted because the issue that REA seeks to raise turns on the specific facts of this case that were decided adversely to REA. These factual findings are binding on REA because it never sustained its burden of establishing that these were clearly erroneous. *See Anderson v. City of Bessemer City*, 470 U.S. 564, 572 (1985).

### Wabash Valley's Regulated, Not-for-Profit Status

Wabash Valley is a not-for-profit generation and transmission electric cooperative ("G&T") organized under Ind. Code §§ 23-7-1.1-1 *et seq.* (App. 70a ¶ 2)[1] The Indiana Utility Regulatory Commission ("IURC") regulates the rates Wabash Valley charges its Members and requires that rates be sufficient to cover only actual power supply costs and a modest capital reserve. (App. 73-74a ¶¶17-18; App. 137a ¶164) If Wabash Valley collects revenues that exceed its actual power supply costs, the IURC requires those overpayments to be credited against future fuel cost increases. (App. 74a ¶18) Indiana law precludes Wabash Valley, as a not-for-profit corporation, from paying any earnings or dividends to its Members. (App. 70a

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[1] Record references are to REA's appendix and the separately numbered paragraphs in the Bankruptcy Court's Findings of Fact. Factual statements in the Bankruptcy Court's Conclusions of Law stand as additional Findings of Fact. (App. 167a ¶246)

¶4) Under Indiana law and Wabash Valley's articles of incorporation, the Members cannot receive or retain any interest in Wabash Valley's assets that can be sold or liquidated at a profit, and upon dissolution of Wabash Valley, any assets remaining after payment of debts and return of capital contributions escheat to the State. (*Id.*)

**The Supply Contracts and REA's Marble Hill Loan Guarantees**

In 1977, Wabash Valley entered into forty-year (later extended for another ten years) all-requirements wholesale power supply contracts ("Supply Contracts") with each of its Members. (App. 72-73a ¶14) Those agreements require IURC regulation of Wabash Valley's rates on a not-for-profit basis and give the Members the right to elect Wabash Valley's directors. (App. 73a ¶15; App. 135a ¶158) If either of these conditions were violated by Wabash Valley (or a successor), this would cause Wabash Valley to breach the agreements and the Members could purchase their power requirements elsewhere. (App. 89-91a ¶¶55-58; App. 134-135a ¶¶157-159)

REA actively encouraged Wabash Valley and other G&Ts to invest in nuclear power plants. (App. 75a ¶20 n.5) Beginning in 1978 Wabash Valley invested approximately $460 million in the Marble Hill nuclear plant that Public Service Company of Indiana ("PSI") was constructing. (App. 75a ¶20) REA approved the Supply Contracts as the primary collateral for its Marble Hill loan guarantees; REA did not seek further repayment guarantees from Wabash Valley's Members. Although the Supply Contracts were patterned after REA's form agreement, the requirement that the IURC must approve the

rates Wabash Valley charges is *not* a standard REA provision. (App. 73a ¶16) REA admitted that it was not aware of any other power supply contract securing REA loans that includes such a specific state rate regulation requirement. (App. 73a ¶16; App. 113a ¶111)

**Wabash Valley's Marble Hill Rate Case**

Following PSI's cancellation of Marble Hill, Wabash Valley prosecuted fraud and other claims against PSI and Marble Hill contractors that resulted in a recovery of over $185 million for the benefit of REA and the other creditors. (App. 78-80a ¶¶27-33) Wabash Valley also tried to restructure its loans with REA and, at REA's insistence, filed a petition for IURC approval for a 51% rate increase to repay the Marble Hill debt. (*Id.*) REA and another Wabash Valley creditor, the National Rural Utilities Cooperative Finance Corporation ("CFC"), intervened and participated fully in the Marble Hill rate case. (App. 75-76a ¶21 n.6) Applying Indiana's "used and useful" rule,[2] the IURC dismissed Wabash Valley's petition. (App. 75-76a ¶21) The Indiana Court of Appeals and Supreme Court subsequently affirmed the IURC's decision and held that because Marble Hill was never "used and

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[2] The Indiana courts applied this same standard to deny any recovery of sunk costs for two Indiana investor-owned utilities, NIPSCO and PSI, that also had invested substantial amounts in canceled nuclear power plants. *See Citizens Action Coalition of Indiana, Inc. v. Northern Ind. Pub. Serv. Co.*, 485 N.E.2d 610, 614-615 (Ind. 1985), *cert. denied*, 476 U.S. 1137 (1986); *Citizens Action Coalition of Indiana, Inc. v. Pub. Serv. Co. of Ind., Inc.*, 552 N.E.2d 834, 837, 840 (Ind. App. 1990); and *Citizens Action Coalition of Indiana, Inc. v. PSI Energy, Inc.*, 664 N.E.2d 401, 403-404 (Ind. App. 1996).

useful," Wabash Valley cannot raise rates to repay the Marble Hill loan guarantees. *Nat'l Rural Utilities Coop. Fin. Corp. v. Public Service Comm'n of Ind.*, 552 N.E.2d 23, 27-28 (Ind. 1990) (App. A 9-10), *aff'g* 528 N.E.2d 95 (Ind. App. 1988). REA was a moving party in the appeals to the Indiana Court of Appeals and Supreme Court. REA did not seek review of the Indiana Supreme Court's decision by this Court.

As of the petition date, Wabash Valley owed REA $669 million, of which approximately $540 million was Marble Hill-related. (App. 76-77a ¶ 23)

**REA's Attempts to Preempt State Regulation of Wabash Valley's Rates**

After the Indiana Court of Appeals affirmed the dismissal of Wabash Valley's request to raise rates to pay for Marble Hill, REA sent letters to Wabash Valley, the IURC and the Michigan Public Service Commission purporting to preempt state regulation of Wabash Valley's rates. (App. 85a ¶45) The Seventh Circuit unanimously affirmed the District Court's conclusion that REA's conduct was "arbitrary, capricious, not in accordance with law, and of no force and effect whatever," stating that "[a]fter all, the REA made its loans and guarantees on the assumption that state regulation would apply." *Wabash Valley Power Ass'n, Inc. v. Rural Electrification Administration*, 903 F.2d 445, 455 (7th Cir. 1990) (App. B 20), *aff'g* 713 F. Supp. 1260 (S.D. Ind. 1989) ("*Wabash Valley v. REA I*"). The Court of Appeals also ruled that claim preclusion barred REA from raising an implied preemption argument when REA had failed to make such an assertion in Wabash Valley's Marble Hill rate case.

*Id.* REA did not ask this Court to review the Seventh Circuit's decision.

On the eve of the confirmation hearing, REA once again tried to preempt state regulation of Wabash Valley's rates, this time by formal rulemaking. (App. 86a ¶47) And once again both the District Court and Seventh Circuit held that REA lacked authority to preempt state rate regulation on an *ad hoc* basis whenever rates did not generate sufficient revenues to repay REA loans. *Wabash Valley Power Ass'n, Inc. v. Rural Electrification Administration*, 988 F.2d 1480 (7th Cir. 1993) (App. C), *aff'g* 773 F. Supp. 1178 (S.D. Ind. 1991) ("*Wabash Valley v. REA II*"). The Seventh Circuit reasoned that the Rural Electrification Act reflected the assumption by Congress that "REA could protect itself by setting conditions on the extension of credits," including commitments by state regulators to set rates high enough to enable loan repayment. App. C 23-24, 988 F.2d at 1490-91. The Seventh Circuit stated that "REA failed to so qualify its loan guarantees to Wabash Valley" and that "[d]istilled to its essence, the REA would have Wabash Valley's subscribers absorb the losses stemming from Wabash Valley's default and the REA's mishandling of its security arrangement." App. C 24, 988 F.2d at 1491. The Court of Appeals concluded that REA lacked the authority to dictate who shall bear the risk of non-payment, especially because the reasonable interpretation of "the structure and operation of the subsidies provided through the REA reflect a congressional preference for the government's bearing this risk, rather than cooperative members." *Id.* Once again, REA did not seek review by this Court.

**Valuation of Wabash Valley**

REA does not mention, much less challenge in its petition, the exhaustive consideration that the courts below gave to the valuation of Wabash Valley, even though valuation is a critical step in the reorganization process because it defines how much Wabash Valley's creditors can recover and whether Wabash Valley should be reorganized and continue operations or be liquidated. The parties stipulated that the liquidation value of Wabash Valley's physical assets was $175 million. (App. 81a ¶36; App. 136a ¶160) The Bankruptcy Court found—and the District Court affirmed (App. 48a)—that Wabash Valley's fair market value as a going concern was no more than $190 million. (App. 136-154a, in particular ¶201) Wabash Valley's going concern value was limited by its unique status as a regulated not-for-profit utility where its principal asset, the Supply Contracts, require state regulation of Wabash Valley's rates on a not-for-profit basis and give the Members the right to elect Wabash Valley's directors. (App. 135a ¶158) If these contract rights were breached, the Supply Contracts would not be enforceable against the Members and they would be free to purchase their power requirements elsewhere. (App. 134-135a ¶¶157-159)

The Bankruptcy Court also valued Wabash Valley based on the cost savings it provides for its Members compared to alternative power sources. (App. 98-102a ¶¶75-85) The Court found that Wabash Valley was more valuable to its Members than to any other potential buyer "because Wabash Valley is tailored exactly to their requirements" (App. 101a ¶82), and that $221.7 million was the most that Wabash Valley's Members would pay to continue its operations, or what one witness referred

to as "the maximum value you could possibly squeeze out . . . of [the Members] before it would pay them to go find other arrangements." (App. 155-158a ¶¶207-209, 213) The Seventh Circuit specifically affirmed the Bankruptcy Court's findings on the Supply Contracts and valuation as not clearly erroneous. *In re Wabash Valley Power Ass'n, Inc.*, App. 5-12a, 72 F.3d at 1309-1313.

The valuations of Wabash Valley were corroborated by the fact that REA had conducted a *de facto* auction of Wabash Valley, and no buyer was willing to offer more than the $221.7 million that the Members pay under the Wabash Valley Plan. REA conceded having received "expressions of interest" from three utilities—two for-profit, investor-owned utilities, PSI and Indianapolis Power & Light, and Big Rivers, a Kentucky-based G&T—and that PSI had made "a very formal offer" to REA. (App. 112-114a ¶¶110, 114; App. 182-183a ¶38) REA rejected the PSI offer, never advised the Court of the terms PSI offered, nor did REA ever seek the Court's approval of *any* offer to acquire Wabash Valley. (*Id.*) The Bankruptcy Court made a specific finding that "the reasonable inference is that none of the utilities that had expressed interest in acquiring Wabash was willing to submit a bid that surpassed what Wabash is proposing to pay REA and the other creditors . . . . [I]f REA had received a better offer, REA certainly would have presented that offer for the Court's consideration. REA never did." (App. 182-183a ¶38)

Under the Wabash Valley Plan, REA and the other creditors will receive payments having a present value of $457 million (including Marble Hill-related settlements worth at least $185 million that Wabash Valley obtained), compared with only $175 million if Wabash

Valley's tangible, useful assets were liquidated. (App. 67a; App. 81a ¶36) Simply put, under the Wabash Valley Plan REA and the other creditors will receive *$282 million more* than they will under the only alternative now proposed by REA, liquidation. REA will receive nearly $431 million under the Wabash Valley Plan (App. 67a), or $256 million more than it would recover if Wabash Valley were liquidated.

## REASONS FOR DENYING THE WRIT

### I.

### THE SEVENTH CIRCUIT DID NOT CREATE AN EXCEPTION TO THE ABSOLUTE PRIORITY RULE FOR NOT-FOR-PROFIT COOPERATIVES.

REA misstates or ignores binding factual findings and settled legal principles to give the false impression that the Seventh Circuit created "an exception to the absolute priority rule for not-for-profit cooperatives." (REA Pet. 8, 12, 14, 17, 18)

The Seventh Circuit never even suggested such an exception. The Court of Appeals properly applied the absolute priority rule and concluded that the Members' right to choose the directors of the reorganized Wabash Valley does not violate the rule because based upon Wabash Valley's unique circumstances the Members have no equity interest in Wabash Valley and no present or future ability to profit at REA's expense.

REA ignores that the Seventh Circuit explicitly applied the absolute priority rule to "the unusual structure of the entities involved"—particularly the Members' unique interests in Wabash Valley which is both a not-for-profit *and* regulated cooperatively owned utility—that made

"the rules of Chapter 11 bankruptcy, primarily designed as they are for profit-seeking enterprises . . . less than straightforward to apply here." App. 15-17a, 72 F.3d at 1313-1314. The Court of Appeals ultimately concluded that "[b]ecause of the way in which the rights of the Members of Wabash are constrained both by state law and by the organization's own bylaws, we believe the Members may continue in control of the reorganized co-operative *without violating the absolute priority rule.*" App. 20a, 72 F.3d at 1315 (emphasis added). The Seventh Circuit further noted that *"[b]eyond complying with the rule*, this outcome also seems to make economic sense, since it maximizes the value available to meet creditor claims." *Id.* (emphasis added).

Under the absolute priority rule as incorporated in 11 U.S.C. § 1129(b)(2)(B)(ii), the question is whether Wabash Valley's Members are "old equity" holders who have traded on their "insider" status to acquire "new equity" in the reorganized Wabash Valley while REA receives less than full repayment of its unsecured claim. App. 19a, 72 F.3d at 1318. The short answer is that the Members have no "equity interest" in Wabash Valley. The findings of facts by the Bankruptcy Court (App. 70-78a ¶¶2, 4, 14-15), which the Seventh Circuit sustained (App. 16a, 72 F.3d at 1313), establish that under the governing Indiana statutes and Wabash Valley's articles of incorporation and bylaws, the Members cannot receive any profits or dividends, and they have no present or prospective ownership interest in Wabash Valley's assets that can be sold or liquidated at a profit. In the Marble Hill rate case, the Indiana Supreme Court previously determined that the Members are not "investors" in Wabash Valley, App. A 7-8, 552 N.E.2d at 27, a decision that is binding

on REA here. In *Wabash Valley v. REA I*, another panel of the Seventh Circuit similarly concluded that "non-profit utilities are not supposed to make 'profits' and do not have 'equity investments' in the legal sense. . . ." App. B 7, 903 F.2d at 449. The Seventh Circuit thus properly concluded here that under Indiana law, Wabash Valley's articles of incorporation and bylaws, the Members have no equity interest in Wabash Valley.

Similarly, the Members' right to elect the directors of the reorganized cooperative does not violate the absolute priority rule. The Supply Contracts, which Wabash Valley assumes under 11 U.S.C. § 365, require that the IURC continue to regulate Wabash Valley's rates on a not-for-profit basis and that the Members retain the right to elect Wabash Valley's directors. The Seventh Circuit affirmed the Bankruptcy Court's findings (App. 89-92a ¶¶55-60; App. 134-135a ¶¶157-158) that a violation of either of these conditions would breach the Supply Contracts and free the Members to purchase their power requirements elsewhere. App. 10a, 72 F.3d at 1311. Wabash Valley must assume the Supply Contracts in their entirety so that the Members remain obligated to purchase their power requirements from Wabash Valley, thus producing a future income stream for the benefit of REA and the other creditors. If the Supply Contracts were invalidated and Wabash Valley liquidated as REA proposes, REA would receive *$256 million less* than it will under the Wabash Valley Plan.

In this connection, the Seventh Circuit noted that "control" alone is not the determinative issue and that the absolute priority rule is implicated only where those in control can realize a financial gain by sharing in the reorganized entity's profits or assets. App. 29a, 72 F.3d

at 1318. The Seventh Circuit correctly concluded that Wabash Valley's Members "are not owners in any usual sense of the term," App. 16a, 72 F.3d at 1313, because there is no possibility that the Members can profit, now or in the future, at REA's expense. The Seventh Circuit explained how Wabash Valley's unique status as a *regulated and not-for-profit* electric utility clearly distinguishes Wabash Valley from the for-profit farmers in *Ahlers* and *Unruh* who retained the "right to the future profits of their farms," 987 F.2d at 1508, as well as their interests in the land that could be liquidated at an appreciated value for a profit in the future:

> Pursuant to state law and the rules of the cooperative, Wabash Members receive no profits, nor do they have any current or prospective ownership rights in the corporate assets. Under Indiana law any assets remaining to the cooperative after a liquidation or dissolution escheat to the state.
>
> * * *
>
> Control of the cooperative provides no opportunity, either currently or in the future, for the Members to obtain profits or any equity in Wabash's assets and control itself is not an equity interest. Further, control of Wabash's Board provides the Members with no opportunity to benefit at REA's expense. App. 16a, 33a, 72 F.3d at 1313, 1320.[3]

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[3] In return for their agreement to purchase their power requirements from Wabash Valley for forty years, the Members bargained for and received certain rights to protect their interests, including the rights to elect Wabash Valley's directors and to have the IURC regulate its rates. (App. 89-91a ¶¶55-58; App. 134-135a ¶¶157-159) The Wabash Valley Plan allows the

(continued...)

Wabash Valley is unique because none of the incidents of control of a for-profit business exists. Under the binding facts found by the Bankruptcy Court and the legal principles settled by prior decisions of the Indiana Supreme Court and the Seventh Circuit, Wabash Valley cannot earn a profit from ongoing operations, nor can it pay a dividend to the Members.[4] And unlike the debtors in *Ahlers* and *Unruh*, the Members have no current or prospective ownership interest in Wabash Valley's assets that can be sold or liquidated at a profit.[5] Under these specific circumstances, the Members' right to "control" the reorganized Wabash Valley by continuing to elect its directors is clearly distinguishable from the typical for-

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[3] (...continued)
Members to maintain the system of governance and communications that they have developed over many years to share information and resolve common issues through collective efforts.

[4] That the Seventh Circuit's decision was grounded upon legal and factual considerations that are unique to Wabash Valley is demonstrated by the fact that the Court of Appeals considered and distinguished other "not-for-profit" cases such as *In re Eastern Maine Electric Coop., Inc.*, 125 B.R. 329 (Bankr. D.Me. 1991), as "decided under Maine law and under different corporate articles and bylaws. . . ." App. 23a, 72 F.3d at 1316. The Court of Appeals further stated that "relevant decisions of the [Indiana] state courts involving Wabash and the particulars of the Wabash bylaws both distinguish this case" from *Eastern Maine*. App. 25a, 72 F.3d at 1317.

[5] *Ahlers* is also distinguishable because the debtors did not contest the conclusion that their retaining an equity interest in the for-profit farm violated the absolute priority rule. 485 U.S. at 202. Moreover, unlike here where *all* creditors will receive substantially more under the Wabash Valley Plan, only the wholly unsecured creditors fared better under the debtors' plan in *Ahlers*. *Id.* at 206.

profit debtor. There is no possibility that the Members can "profit" in the future while REA receives less than full repayment of its unsecured claim.[6]

REA effectively concedes this point and argues instead that the Members may benefit by paying lower prices for power if Wabash Valley remains in existence. But that is precisely the reason for a not-for-profit cooperatively owned electric utility. The Seventh Circuit correctly held that this "potential for lower prices" does not implicate the absolute priority rule because such lower rates are not "property received on account of an equity interest." App. 28a, 72 F.3d at 1318. The rates that the Members pay are a result of Wabash Valley's unique status as a *state-regulated*, not-for-profit utility. Indiana law requires the IURC to set Wabash Valley's rates to cover only its actual power supply costs. If Wabash Valley's rates produce revenues beyond those costs, those overpayments must be credited against fuel cost increases. (App. 10a, 72 F.3d at 1311; App. 74a ¶18; App. 137a ¶164) As the

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[6] Contrary to REA's contention (Pet. 8 n.6), the Seventh Circuit did not reach the so-called "new value exception" to the absolute priority rule in this case, App. 19a, 72 F.3d at 1315, and, therefore, this is not an issue properly raised by REA's petition. Nevertheless, the Wabash Valley Plan also satisfies the new value exception because the Members will make "a substantial, necessary, and fair new value contribution" of $3.2 million. *See generally In re Bonner Mall Partnership*, 2 F.3d 899, 908-909 (9th Cir. 1993), *cert. dismissed and vacatur motion denied sub nom. U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 513 U.S. ___, 115 S. Ct. 386 (1994). Although in *Ahlers* this Court declined to reach the issue whether this exception survived the adoption of the 1978 Bankruptcy Code, "the majority of courts that have considered the question have held that the new value exception is alive and well." *Id.* at 907.

Seventh Circuit stated, Wabash Valley's assumption of the Supply Contracts under its Plan (and under 11 U.S.C. § 365) "will obligate the Members to fulfill all their obligations under the Contracts and will entitle them to all the benefits of the Contracts including the right to name Wabash's Board of Directors." App. 14a, 72 F.3d at 1312-1313. The Members' primary obligation under the Supply Contracts is to purchase their power requirements from Wabash Valley until 2027. Wabash Valley has corresponding contractual obligations, including the requirement to provide reliable service to the Members at the lowest possible cost. REA understood and approved those provisions of the Supply Contracts as the primary collateral for its Marble Hill loan guarantees. Under these circumstances, Wabash Valley's contractual obligation to seek and obtain power supply options that may result in lower prices for the Members does not implicate, much less violate, the absolute priority rule.

Moreover, REA could not recover any more than what it will receive under the Wabash Valley Plan even if there were an equity interest in Wabash Valley that REA could assume. REA is bound by the Bankruptcy Court's finding, reviewed and accepted by the Seventh Circuit (App. 122a, 72 F.3d at 1312), that Wabash Valley's maximum value is the $221.7 million that the Members will pay under the Wabash Valley Plan. Even if REA controlled Wabash Valley, it could not earn a profit or pay a dividend to itself because under settled principles of Indiana law and the Supply Contracts, Wabash Valley's rates must cover only actual power supply costs. If REA tried to set higher rates, IURC regulations require that "any excess of revenues over expenses and

over a limited reserve must be credited against fuel adjustment charges." App. 10a, 72 F.3d at 1311.

In any event, the Bankruptcy Court valued the future benefits to the Members of being able to aggregate their power purchases through Wabash Valley (the $31.7 million difference between Wabash Valley's $190 million going-concern value and the $221.7 million value to the Members), and that amount will be paid to REA and CFC on their unsecured claims. The Bankruptcy Court correctly concluded that by identifying and paying this "significant tangible premium" for the benefit of REA and the other creditors, "there is no residual economic benefit for Wabash's Members." (App. 184-186a ¶¶41, 45) Thus, even if the benefits of possible lower prices in the future implicated the absolute priority rule, which they do not, under the Wabash Valley Plan the Members pay the creditors the full value of any price benefits they may obtain through a reorganized Wabash Valley.

The Bankruptcy Court's valuation analysis and findings are also dispositive of REA's argument (REA Pet. 19) that the reorganized Wabash Valley could convert to a for-profit entity. First, REA ignores the fact that the Supply Contracts require Wabash Valley to be operated as a regulated, not-for-profit utility. (App. 67a; App. 89-91a ¶¶56-58) Second, the Bankruptcy Court's $190 million going concern valuation of Wabash Valley was premised upon a sale to a for-profit purchaser and the conversion of Wabash Valley to a for-profit utility. (App. 92-98a ¶¶61-74; App. 136-141a ¶¶160-175)[7] Finally, the two for-

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[7] As part of its valuation findings, the Bankruptcy Court found that the Members have no incentive to renegotiate the (continued...)

profit utilities that expressed interest in acquiring Wabash Valley and converting it into a for-profit enterprise were not willing to submit bids that even matched the $221.7 million that the Members will pay under the Wabash Valley Plan. (App. 182-183a ¶38) Contrary to REA's speculation, the fact is that the market placed a very low value on the opportunity to convert Wabash Valley to a for-profit entity.

REA's real complaint is that it has not been able to impose any rate increase to repay the Marble Hill loan guarantees. REA's position is untenable because it ignores the dispositive holding by the Indiana Supreme Court and two previous decisions by the Seventh Circuit holding that REA cannot preempt state rate regulation to raise Wabash Valley's rates to pay for Marble Hill. As the Seventh Circuit previously recognized, REA's predicament is simply because REA accepted as its primary collateral Supply Contracts "with Wabash's customers that oblige them to pay no more than the state rate; it did not secure [member] guarantees." *Wabash Valley v. REA I*, App. B 16, 903 F.2d at 453. The current panel of the Seventh Circuit reached the same conclusion: "Two factors *outside the Members' control* have prevented REA from collecting more of its outstanding debt: the nonprofit structure of cooperatives and, most important, the fact that the only conceivable source of funds—increased rates—is foreclosed by state law and the prior decisions of this court." App. 33a, 72 F.3d at 1320 (emphasis

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[7] (...continued)
Supply Contracts to a for-profit basis unless this would result in rates lower than what the Members would pay their "host" investor-owned utilities if Wabash Valley ceased to exist. (App. 139-140a ¶171)

added). In particular, the "principal reason" the Supply Contracts did not provide a reliable source of revenue to repay the Marble Hill loan guarantees "was the refusal of Indiana regulators to recognize Marble Hill as an asset for ratemaking purposes," a risk that REA knew or should have known of as a promoter of nuclear power. App. 31a, 72 F.3d at 1319.

In short, there is no basis for REA's assertion that the Seventh Circuit created a new exception to the absolute priority rule for not-for-profit cooperatives. The Seventh Circuit's decision rests instead on the unexceptional holding that the question of compliance with the absolute priority rule must be answered by close examination of the governing law and specific facts of each case. Here, the Seventh Circuit carefully applied the rule to Wabash Valley's one-of-a-kind circumstances and found no violation.

## II.

## THE SEVENTH CIRCUIT CORRECTLY RECOGNIZED THAT THE WABASH VALLEY PLAN MAXIMIZES THE CREDITORS' ECONOMIC RECOVERY, AND THE DECISION BELOW WILL NOT ADVERSELY AFFECT REA'S ABILITY TO RECOVER LOANS TO OTHER RURAL ELECTRIC COOPERATIVES.

REA tries to buttress its petition by suggesting (a) that the Seventh Circuit "improperly speculated that [REA] would be better off under the Wabash Plan than under other alternatives" (REA Pet. 11 n.9); and (b) that the decision below will adversely affect its ability to collect loans to other rural electric cooperatives. (REA Pet. 9, 19) Both of REA's arguments are not properly part of the question REA purports to present, and both are clearly contrary to the facts as found by the courts below.

### A. The Undisputed Findings By the Bankruptcy Court Clearly Show that REA Will Recover Substantially More Under the Wabash Valley Plan than REA's Only Alternative, Liquidation.

Contrary to REA's suggestion, the Court of Appeals was not speculating when it observed that the Wabash Valley Plan "makes economic sense" because REA will recover far more than under REA's only alternative, liquidation. REA does not dispute that under the Wabash Valley Plan all creditors will receive $457 million, and REA's share is nearly $431 million. Because REA now has abandoned its own Plan, REA's only alternative to the Wabash Plan is liquidation of Wabash Valley's physical assets which will yield *$282 million less*. Given the constraints of Indiana rate regulation that absolutely prohibit a rate increase to pay for Marble Hill, App. 31a, 72 F.3d at 1319, the Seventh Circuit correctly concluded that the Members' "continuation as customers in control of Wabash is a means of maximizing the value of the estate for the benefit of creditors." App. 27-28a, 72 F.3d at 1318.[8]

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[8] The Court of Appeals recognized that the higher return for REA under the Wabash Valley Plan "does not excuse compliance with the absolute priority rule, but it is nonetheless a fact of which we must remain aware." App. 32a, 72 F.3d at 1320. REA's steadfast demand for liquidation confounds common sense. A financially accountable commercial lender could never rationalize insisting upon an option that results in a $256 million loss for itself (and $282 million for all creditors).

**B. The Decision Below is Limited to Wabash Valley's Unique Circumstances and Will Not Affect REA's Ability to Collect Loans to Other Rural Electric Cooperatives.**

Equally misplaced are REA's assertions that the decision below will adversely affect REA's loans to other rural electric cooperatives. REA submitted no evidence below to support these claims.[9] And once again REA ignores the numerous facts, found below and binding on REA, that are unique to REA's Marble Hill loan guarantees and that establish that Wabash Valley's situation is *sui generis* and will not recur if REA places appropriate conditions on extensions of credit. The critical fact concerning REA's Marble Hill loan guarantees is that REA accepted as its collateral Supply Contracts that are expressly conditioned upon state rate regulation which, in turn, resulted in the application of Indiana's used-and-useful rule when PSI abandoned Marble Hill. This pro-

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[9] REA's conduct contradicts the argument it makes here. REA recently agreed to write off $982 million of the $1.22 billion (for a net recovery of $237 million) that another G&T, Soyland Power Cooperative, had borrowed with REA loan guarantees to invest in Illinois Power's Clinton nuclear plant. *The Wall Street Journal*, at A-4 (September 16, 1996); *Electric Utility Week*, at 3 (September 23, 1996). REA's decision to accept this writedown has nothing to do with the Seventh Circuit's decision here since Soyland had not filed for reorganization and operates in a state, Illinois, that does not regulate cooperatives' rates. REA also recently agreed to write down $530 million in loans to Deseret Generation & Transmission Cooperative as part of a larger REA bailout of its "troubled" borrowers. *The Wall Street Journal*, at A-3 (October 3, 1996). REA's insistence that Wabash Valley be liquidated is inexplicable if REA's objective actually were to maximize its recovery on troubled loans. Liquidation of Wabash Valley would mean that REA would receive $256 million less than it would receive under the Wabash Valley Plan.

vision is unique to the Wabash Valley Supply Contracts. (App. 73a ¶15; App. 135a ¶158)

REA has no basis to suggest that the outcome here poses a "significant threat . . . to [REA's] legitimate . . . expectations" as a creditor. (REA Pet. 19-20) If Marble Hill was not completed—clearly a foreseeable risk for REA as lender—the reasonable expectation was that the IURC would apply Indiana's longstanding used and useful rule and bar any recovery of Marble Hill costs through rates. As the Indiana Supreme Court stated: "At the time the Wabash loan was approved, the REA administrator knew or should have known that Wabash's requirements contracts with its members served as the security for the loan and that those contracts provided that the rates paid by the members had to be approved by the [Indiana] commission, and this knowledge was or should have been factored into REA's decision to make the loan." App. A 12-13, 552 N.E.2d at 29.

REA's unsupported concerns about its relations with other borrowers hardly are a sufficient basis for this Court to grant review. This is particularly true because REA has the responsibility to insure that its loans are properly collateralized. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 729 (1979) (rejecting argument that "nationwide standards favoring claims of the United States are necessary . . . to safeguard the Federal Treasury from defaulting debtors."). The Seventh Circuit summarized REA's remedy in *Wabash Valley v. REA I*:

> Congress' assumption when it created the Rural Electrification Act in 1936 seems to have been that the REA could protect itself by setting conditions on the extension of credit. . . . The REA may refuse to make loans unless state agencies

> guarantee rates high enough to allow repayment. It may refuse to approve a loan unless the customers (whose promises to buy power are the real security for the debt) guarantee the loan or authorize the REA to dictate rates. If either state or customer balks, the REA may deploy its funds elsewhere. . . . The conditioning power is a big club, which can achieve (effective) preemption and more. . . . But REA did not use this power when extending credit [to Wabash Valley]. It approved contracts with Wabash's customers that oblige them to pay no more than the state rate; it did not secure [member] guarantees. App. B 15-16, 903 F.2d at 453.

REA also fails to inform this Court of a critical fact that differentiates Wabash Valley's situation from REA's other purportedly "troubled" borrowers. None of REA's loans to other G&Ts involves a project like Marble Hill that was abandoned before completion. In all other instances, REA has a security interest in actual "used and useful" assets that were completed and have substantial value. For example, another major REA G&T borrower involved in a bankruptcy proceeding is Cajun Electric Power Cooperative, and several bidders have offered roughly $1 billion to acquire Cajun's non-nuclear generating assets that were financed with REA loan guarantees. *Electric Utility Week*, at 14 (September 2, 1996).[10] In addition, REA's predictions of imminent financial ruin are belied by the fact that only a small minority of states

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[10] The financial problems of another REA G&T borrower, Big Rivers, that recently filed for bankruptcy relate to a surplus of high-cost generating capacity, not a project like Marble Hill that was abandoned before completion. *Electric Utility Week*, at 1 (September 30, 1996).

regulate cooperatives' rates, *Wabash Valley v. REA I*, App. B 2, 903 F.2d at 448, and an even smaller minority strictly apply the used-and-useful rule. And even the Indiana statutes were amended in 1985 to allow utilities to recover through rates prudent expenditures for post-April 1985 capital projects abandoned before completion, provided the IURC previously had reviewed and certificated such projects. *See* Ind. Code §§ 8-1-8.5-1 *et seq.*

Finally, because the Seventh Circuit's decision is limited by Wabash Valley's idiosyncratic factual and legal considerations—most especially its status as a regulated and not-for-profit public utility—this case does not, as REA asserts (REA Pet. 9, 19), provide a "roadmap" for other non-profit debtors such as homeowners' associations to avoid compliance with the absolute priority rule.[11] On the contrary, in the decision below and in its two previous preemption decisions, the Seventh Circuit provided REA with a detailed "roadmap" of the conditions (*e.g.*, binding commitments by state regulators to set rates sufficiently high to repay loans and requiring Member guarantees) that REA could place on extensions of credit to protect its financial interests. *Wabash Valley v. REA I*, App. B 15-16, 903 F.2d at 453; *Wabash Valley v. REA II*, App. C 23-24, 988 F.2d at 1490-1491.

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[11] The Seventh Circuit never suggested that its decision extends to homeowners' associations or other nonprofit entities as REA suggests. (REA Pet. 17, 20-21) On the contrary, the Court of Appeals emphasized that Wabash Valley's defining characteristic is that its operations—and most significantly the rates it can charge—are regulated by the IURC pursuant to a comprehensive statutory scheme.

## III.

## REA'S ASSERTION OF AN UNQUALIFIED RIGHT TO VETO THE WABASH VALLEY PLAN HAS NO SUPPORT IN THE BANKRUPTCY CODE AND IS INCONSISTENT WITH THE PUBLIC POLICY THAT UNDERLIES CHAPTER 11.

The practical thrust of REA's petition is that as the principal creditor REA has an unreviewable right to liquidate Wabash Valley without any judicial "second-guessing" even if creditors receive much less through liquidation.[12] REA's position is refuted by clear statutory language and is plainly inconsistent with the public policy to rehabilitate debtors that underlies Chapter 11.

11 U.S.C. § 1129(a)(10) expressly provides that a plan may be confirmed over the dissent of one or more creditors if at least one class of impaired claims votes in favor of confirmation, even if the class holds a minority of the debt. *See generally Matter of Briscoe Enterprises, Ltd., II*, 994 F.2d 1160 (5th Cir.), *cert. denied,* 510 U.S. 992 (1993) (plan approved over objections of majority credi-

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[12] REA argues, for example, that a reorganization proceeding is nothing more than a device to sell the debtor to the creditors. (REA Pet. 11) In *Wabash Valley v. REA I*, App. B 19, 903 F.2d at 455, the Seventh Circuit concluded that REA "seeks not neutrality but preference" because REA attempted to preempt state regulation of Wabash Valley's rates even though the Indiana Commission and courts had applied the used-and-useful requirement in a nondiscriminatory fashion to all Indiana utilities, including Wabash Valley's partner in the Marble Hill project, PSI. *Wabash Valley v. REA II* rejected REA's attempt to manipulate the bankruptcy process to give REA the exclusive right to set the rates of any cooperative that files for bankruptcy as an invalid attempt by REA "to shift the risk of default on REA loans from the REA to cooperative members." App. C 4, 988 F.2d at 1483.

tor). Section 1129(b)(1) similarly provides that a court *"shall confirm"* a reorganization plan notwithstanding the objections of a class of creditors if the plan does not discriminate against and is fair and equitable with respect to each impaired, non-consenting class of claims. Had Congress intended to limit cramdown to cases where a plan is supported by creditors holding a majority of the debt, it easily could have drafted § 1129 to require that result. On the contrary "the very purpose of the Code's cramdown provision . . . is to allow the court, not the creditors, to decide whether a 'fair and equitable' plan should be confirmed over creditor objections." *In re Bonner Mall Partnership*, 2 F.3d at 915. REA has no unqualified right to derail confirmation of the otherwise "fair and equitable" Wabash Valley Plan, especially because REA now concedes that the Wabash Valley Plan satisfies all the other requirements for cramdown.

REA also ignores the fact that it is not the only party with an interest in Wabash Valley's bankruptcy. Other creditors such as CFC and PSI have a significant interest in Wabash Valley's continued operations. CFC did not appeal from the Bankruptcy Court's confirmation of the Wabash Valley Plan even though its pre-petition claim was roughly $35.5 million. (App. 77a ¶24) PSI, which also asserted over $140 million in claims (App. 77-78a ¶26), voted in favor of the Wabash Valley Plan. App. 14a, 72 F.3d at 1313.

Moreover, in adopting the statutory framework for reorganizations under Chapter 11 of the Bankruptcy Code, Congress articulated a strong policy in favor of the rehabilitation of debtors especially where a creditor, such as REA here, is intent on liquidating the debtor regardless of the cost to itself and others. *Briscoe Enterprises*,

994 F.2d at 1162 n.1 ("The policy is that the public good is served by rehabilitations and a law that prevents creditors from getting immediate satisfaction but gives the creditor as much as the creditor could get upon liquidation and compensates him or her for the delay is proper to force upon creditors."). REA's preference for a rule that prohibits electric cooperatives from ever filing for reorganization cannot be squared with the purpose of Chapter 11. "[W]hile the protection of creditors' interests is an important purpose under Chapter 11 . . . successful debtor reorganization and maximization of the value of the estate are the primary purposes." *In re Bonner Mall Partnership*, 2 F.3d at 915-916, *citing NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984) and *Toibb v. Radloff*, 501 U.S. 157, 163-164 (1991). These policy concerns are especially important here because REA's only alternative to the Wabash Valley Plan is liquidation and a much smaller recovery for all creditors. Chapter 11 was designed to avoid precisely such economically irrational liquidations, and by permitting reorganizations, "Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap.'" *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983).

## CONCLUSION

REA fails to inform this Court of the unique circumstances of this case and further ignores or misstates numerous factual findings and settled legal principles that are binding on REA here. Contrary to REA's claims, the Seventh Circuit did *not* create a new exception to the absolute priority rule for not-for-profit cooperatives. The Court of Appeals carefully applied the absolute priority rule to Wabash Valley's unique circumstances as a regulated, not-for-profit cooperative and correctly found that the Wabash Valley Plan clearly satisfies the rule. The Wabash Valley Plan is also consistent with the rationale of the absolute priority rule because, based upon the Bankruptcy Court's findings of fact and the settled legal principles previously determined by the Indiana Supreme Court and the Seventh Circuit, the Members' control of the reorganized debtor provides them no opportunity to benefit at REA's expense. There is no possibility for the Members, either currently or prospectively, to obtain profits or any interest in Wabash Valley's assets that can be liquidated at a profit. The Seventh Circuit correctly noted that the Wabash Valley Plan also makes economic sense because the Members' continuation as customers in control of Wabash Valley maximizes the value of the estate for REA and the other creditors.

The bankruptcy process here worked well. Wabash Valley marshaled its assets and recovered over $185 million from the parties responsible for the Marble Hill debacle. As a result, REA and the other creditors receive a total recovery of $457 million—$431 million for REA alone—under the Wabash Valley Plan compared to the $175 million they would recover under REA's only alternative to the Wabash Valley Plan, liquidation.

For the foregoing reasons, Wabash Valley Power Association asks the Court to deny the petition.

Respectfully submitted,

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*Counsel for Respondent*

October 4, 1996

No. 96-342

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1995

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**IN THE MATTER OF WABASH VALLEY POWER ASSOCIATION, INC.**

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**THE UNITED STATES OF AMERICA, ON BEHALF OF THE RURAL ELECTRIFICATION ADMINISTRATION,**

*Petitioner,*

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**WABASH VALLEY POWER ASSOCIATION, INC.,**

*Respondent.*

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**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit**

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## APPENDIX TO BRIEF IN OPPOSITION

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# APPENDIX A

NATIONAL RURAL UTILITIES
COOPERATIVE FINANCE CORPORATION,
Appellant,
v.
PUBLIC SERVICE COMMISSION OF INDIANA,
Wabash Valley Power Association, Inc.,
Office of the Utility Consumer Counselor,
City of Fort Wayne, Indiana, Public Service
Company of Indiana, Inc., Fruit Belt Electric
Cooperative, Jay County REMC, United REMC,
Warren County REMC, Boone County REMC,
Kankakee Valley REMC, and United States of
America on Behalf of Its Rural Electrification
Administration, Department of Agriculture, Appellees.

UNITED STATES of America, Appellant,
v.
PUBLIC SERVICE COMMISSION OF
INDIANA, et al.

No. 93S02-9003-EX-215

Supreme Court of Indiana.

March 21, 1990.

DeBRULER, Justice.

Appellants here are the Rural Electrification Administration of the United States government (REA) and National Rural Utilities Cooperative Finance Corporation (CFC), lenders who advanced funds to the Wabash Valley

Power Association (Wabash) to be used toward the completion of the Marble Hill nuclear power generation plant, a joint enterprise Wabash had undertaken in conjunction with Public Service Company of Indiana. Following the abandonment of construction at Marble Hill, Wabash filed a petition with the Public Service Commission of Indiana (now the Indiana Regulatory Commission) for a fifty-one percent rate increase intended to generate funds to pay project-related debts. The commission dismissed Wabash's petition with prejudice, noting that under this Court's holding in *Citizens Action Coalition v. Northern Indiana Public Service Co.* (1985), Ind., 485 N.E.2d 610 *(NIPSCO)*,[1] a utility may not recover sunk costs associated with the cancellation of a nuclear power project through a rate increase. The Court of Appeals affirmed the commission's decision, fully addressing the issues raised by REA and CFC in their appeal. *National Rural Utils. Coop. Fin. Corp. v. Public Serv. Comm'n* (1988), Ind. App., 528 N.E.2d 95. We grant the petitions for transfer and affirm pursuant to Indiana Rule of Appellate Procedure 11(B)(3). A brief summary of the resolution of the issues raised on appeal follows.

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[1] NIPSCO has twice appealed unsuccessfully from orders subsequently entered in that cause. The resolution of the latest appeal appears in *Northern Indiana Public Service Co. v. Citizens Action Coalition of Indiana, Inc.* (1989), Ind., 548 N.E.2d 153. That decision, which reaffirms our original holding that a utility cannot recover sunk costs associated with a failed nuclear facility through a rate increase and which clarifies the entitlement of ratepayers to interest on refunds and to attorneys' fees, does not affect the reasoning nor the validity of the Court of Appeals' decision in this case and will not be further cited in this opinion.

I. *The commission acted within its jurisdiction when it entered its order since the order constituted neither an advisory opinion nor a declaratory judgment.*

A.

REA argued that because Wabash did not strongly support its petition for a rate increase, there was no case or controversy before the commission and that the resulting order was therefore merely an advisory opinion, which the commission had no jurisdiction to enter. Jurisdiction requires an actual, existing justiciable controversy between adverse parties. One aspect of adverseness is the propriety and ability of one of the parties to call upon the tribunal to adjudicate its cause. Because all rate increases must be approved by the commission, it had primary jurisdiction to hear the petition, and as the entity seeking the increase, Wabash was the proper party to invoke the commission's jurisdiction. The validity and desirability of the proposed rate increase, which would have had an immediate and substantial impact on Wabash, its ratepayers, and its creditors, was vigorously contested by adversarial, interested parties and intervenors. The commission's order was a ruling on a live case or controversy and not an advisory opinion.

B.

REA argued that the commission exceeded its jurisdiction by issuing what amounted to a declaratory judgment. The commission's duty is to enter orders based on impartial findings of fact, and the commission is not empowered to enter declaratory judgments. REA contended that because no factual record existed as to whether Wabash was entitled to emergency rate relief, the com-

mission had issued a premature legal opinion, i.e., an impermissible declaratory judgment. However, these parties appeared before the commission to contest the merits of a proposed rate increase, not to have their rights, status, and relations determined. The commission's order was a ruling on a pending petition, and the commission was not stripped of its jurisdiction because this ruling was based on the legal conclusion that *NIPSCO* controlled the outcome of the controversy at hand nor because the rights of Wabash's creditors would be affected by its decision.

II. *The commission did not abuse its discretion by dismissing Wabash's petition on the merits rather than for lack of prosecution.*

REA and CFC argued that since Wabash's petition could have been dismissed procedurally for failure to prosecute under 170 I.A.C. 1-1-21, the commission committed error when it dismissed the petition on its merits. The cited provision gives the commission the discretion to dismiss a petition for failure to prosecute if there has been no activity on the petition for six months and after notice has been given to the parties that the dismissal will occur. Wabash requested and was granted a stay in the proceedings pending the decision of this Court in *NIPSCO*. The commission did not exercise its discretion to dismiss for failure to prosecute and did not give the requisite notice of dismissal. In light of Wabash's request and the determinative impact that *NIPSCO* had on the case at hand, the commission did not err in dismissing Wabash's petition on its merits.

III. *The commission did not err in concluding that Wabash was not entitled to the rate relief it requested.*

This Court held in *NIPSCO* that an investor-owned utility cannot implement a rate increase to recover costs associated with a facility which was never used or useful in the production of energy. This holding is applicable to and determinative of the issue at hand, appellants' efforts to distinguish their situation from that in *NIPSCO* notwithstanding.

A.

REA and CFC sought to distinguish this case from *NIPSCO* on the basis that the ratepayers here were the owners, and therefore the risk-bearers, of the utility. In *NIPSCO,* the utility was investor-owned, and the ratepayers were simply customers paying for service, not investors seeking returns. Appellants contend that, as members of a cooperative association, the ratepayers here were not merely customers, but had invested in the utility and were therefore subject to the risk of loss inherent in any investment activity.

In support of their view, appellants advanced as persuasive authority case law from other jurisdictions in which the courts stated that members of electrical cooperatives were both customers and stockholders of the utility. However, the question presented here, who must bear the risk of loss for a cancelled nuclear power project, is clearly distinguishable from the issues presented in those cases, whether cooperative members are competent to sit on a jury in a trial where the utility is one of the parties and whether a utility has the power of emi-

nent domain. The cases cited by appellants have no applicability, and therefore no persuasive effect, here.

Appellants also advanced a statement made by the commission in an unrelated case, *In re Hoosier Energy Rural Elec. Coop., Inc.* (August 12, 1987 Cause No. 38315), and a quotation from an interim order issued by the commission in this case as evidence that the Wabash ratepayers were investors and should be held subject to risk of loss for the failed Marble Hill project. In *Hoosier Energy*, the commission discussed the financial responsibility of cooperative membership, but the resolution of the case turned on principles unrelated to the "used and useful" standard and is wholly inapplicable here. In an interim order issued in this case, the commission noted that the application of *NIPSCO* to the facts at hand would have the apparent result that no one would be responsible for the debts incurred by Wabash. Wabash, of course, remains responsible for its debts; the question becomes whether it will be able to pay or be forced into bankruptcy like other insolvent debtors, a question which the commission could not, and did not, decide. The commission's powers and duties are to determine the propriety of requested rate increases, not to allocate the responsibility for payment of a utility's debts, and the commission appropriately refrained from issuing a finding that would purport to fix that responsibility. The comment from the commission's interim order cited by appellants provides no basis for imposing on Wabash's ratepayers the obligation to repay Wabash's debts.

The appellants argued that language from *NIPSCO* which shielded the ratepayers in that case from liability for the failed Bailly N-1 project at issue there provided

a basis for subjecting Wabash's ratepayers to liability for the failed Marble Hill project here. We stated in *NIPSCO* that it was inconceivable that

> consumers could be required to replenish lost capital which had never become "used or useful" property or, in other words, be required to act in aid and support of the utility as an insurer of the investor's risk, unless consumers received an interest in return which provided an opportunity to earn a return on the capital supplied.

*NIPSCO*, 485 N.E.2d at 615. The risk of loss for a utility's nuclear power generation project is to be borne by its investors to the extent of their investment. The *NIPSCO* ratepayers were insulated from liability for the Bailly N-1 debts because they were purely consumers of the utility. Appellants contended that the Wabash ratepayers were not purely consumers, but were investors who received "an interest . . . which provided an opportunity to earn a return on the capital supplied" for monies paid into the cooperative and who were subject to risk of loss on their investment.

Cooperatively-owned utilities were created to provide low cost electricity to rural areas which investor-owned utilities found impracticable to service. Stockholders in such a utility are required to "invest" a set amount, termed a membership fee, in order to receive service, and they are refunded any payments made in excess of the charge for service actually received. Appellants made the incorrect assertion that this return of overpayment is the same as a return on an investment, thereby making the cooperative members investors in the utility. The refund of an overcharge is in no way analogous to the payment of a dividend. Further, unlike the stockholder in an in-

vestor-owned utility, these "investors" have no choice as to whether or how much to invest, and the terms of Wabash's articles of incorporation provide that patrons or owners are not to furnish capital to finance utility plants nor are they to recover profits from utility operations, thus precluding meaningful participation in the utility as investors. Finally, allowing a cooperatively-owned utility to generate funds to repay debts incurred in pursuit of a failed nuclear power plant by way of a rate increase would produce the intolerable result of subjecting its "stockholders" to unlimited liability for investment decisions into which they had no input and from which they had no recourse in the marketplace.

Case law from other jurisdictions, statements by the commission in this and other cases, and the language of this Court in *NIPSCO* provide no basis for appellants' assertion that our holding from *NIPSCO* is inapplicable to the controversy at hand.

B.

Appellants next contended that differences in rate-making methodology between investor-owned and cooperatively-owned utilities[2] precluded the application of *NIPSCO* to this case and cited I.C. 8-1-13-17 in support of this proposition. That section, as in effect at the time

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[2] Rates of investor-owned utilities are based on rate of return principles; rates of cooperatively-owned utilities are based on principles of revenue requirements.

of the commission's order,[3] provided in pertinent part:

> A reasonable and just charge for service . . . shall be such charges as shall produce sufficient revenue to pay all legal and other necessary expense incident to the operation of the system, to include . . . interest charges on bonds or other obligations [and] to provide a sinking fund for the liquidation of bonds or other evidences of debt . . . . Any rate too low to meet the foregoing requirements shall be unlawful.

Appellants argued that under this section, any rate which is set so low that a cooperatively-owned utility is unable to pay its debts is unlawful. Their argument, however, failed to consider the statutory definitions of "service" and "system," two key terms which give the above-cited provision its meaning. A utility may impose a charge on its ratepayers only for service, which is defined as "the furnishing of energy, and the rendering of engineering, financial, accounting, or educational services incidental to the production, transmission, or use of energy." I.C. 8-1-13-3(m). Further, the rate a utility charges for the service provided to its ratepayers may include the expenses incurred in the operation of its system, which is defined as "any plant, works, system, facilities, or properties . . . used or useful in the generation, production, transmission, or distribution of energy." I.C. 8-1-13-3(e). Marble Hill provided no energy to Wabash's ratepayers; therefore, any charge purportedly imposed for service would have been inappropriate here. Like-

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[3] An amended version of I.C. 8-1-13-17 went into effect subsequent to the dismissal of Wabash's petition. The provisions of the amended statute are not applicable here.

wise, Marble Hill never became "used or useful" in the production of energy; therefore, none of the operation expenses associated with the project were properly chargeable to the Wabash ratepayers.

A utility's rates must be based on service regardless of method employed by the utility to set them. The distinction between rate-of-return ratemaking and revenue-requirement ratemaking is irrelevant in the context of recovering from ratepayers the costs associated with a facility which was abandoned before becoming used or useful. Appellants' argument that *NIPSCO* does not control the outcome of this case based on this distinction was without merit.

C.

Appellants argued that *NIPSCO* was distinguishable from this case because Wabash received the commission's approval to borrow funds for the Marble Hill project, thereby coming under I.C. 8-1-8.5-5.5, which allows a utility, under specified circumstances, to recover the costs associated with a cancelled facility through a rate increase. Appellants, however, are precluded from claiming entitlement to the statute's protections because they waived the issue by not raising it before the commission. Even in the absence of waiver, this statute was not in effect until well after Wabash invested in the Marble Hill project; therefore, it was not applicable to the facts at hand. I.C. 8-1-8.5-5.5 requires that a commission approval certificate be obtained prior to the onset of a project's construction and that the approval be based on an assessment of consumer needs and a determination that the proposed facility will meet those needs. If changes in

circumstances subsequently warrant modification or revocation of the approval certificate, the ratepayers are properly chargeable with the costs of the facility since both the decision to undertake and the decision to abandon the project were made following a consideration of their effects on the ratepayers.

Prior to the enactment of the statute, utilities had unfettered discretion to make investment decisions, and it was therefore inappropriate to impose on the ratepayers the cost of decisions that had been entered into with no formal analysis, consideration, and determination of how those decisions would affect them. Even had the statute been in effect when Wabash initiated its Marble Hill investment, the statutory prerequisites were not met such as to trigger the availability of a rate increase to recover the costs of the failed facility. Such recovery is allowed only where the commission has analyzed the risks associated with the proposed facility, held a public hearing, issued a certificate approving the construction, then subsequently revoked or modified the certificate. The commission engaged in no risk analysis and held no public hearing, nor did it issue, much less modify or revoke, an approval certificate. Rather than approving the Marble Hill project, as appellants characterize the commission's actions, the commission approved Wabash's request to borrow the funds necessary to finance the investment project that it had decided to pursue. The decision to abandon the Marble Hill construction came from Public Service Indiana upon its determination that it was financially unable to continue the project. I.C. 8-1-8.5-5.5 does not interdict the applicability of *NIPSCO* to this case.

D.

Appellants attempted to distinguish *NIPSCO* on the basis that Wabash is insolvent, whereas *NIPSCO* was not. Our determination of who bore the risk of loss for the cancelled nuclear power facility in *NIPSCO* was not based in any way on the utility's financial stability, and appellants cited no other authority from our courts or legislature in support of this argument. Appellants relied on two commission orders which permitted a rate increase to allow utilities to avoid insolvency. Their reliance, however, is misplaced since the order granting the rate increase in both cases specifically excluded the costs of cancelled facilities from the rate base. Wabash's insolvency does not preclude the application of the holding in *NIPSCO* to the facts at hand.

E.

REA contended that the resolution of this case by the application of *NIPSCO* would be contrary to the historical basis upon which cooperatively-owned utilities were established, namely, the provision of low cost electricity to rural areas. REA noted that future loans and guarantees from REA to Indiana cooperatives, the loss of which would reduce the availability of low cost electricity in the state, may be jeopardized by such a result. Threats of future sanctions by a federal agency provide no basis for acting in contravention of statutory authority and our own precedent. At the time the Wabash loan was approved, the REA administrator knew or should have known that Wabash's requirements contracts with its members served as the security for the loan and that those contracts provided that the rates paid by the mem-

bers had to be approved by the commission, and this knowledge was or should have been factored into REA's decision to make the loan. A federal agency is no more protected from the potential for loss due to the insolvency of a debtor than is any other lender.[4] The ability of REA to exercise its discretion in making or refusing to make future loans depending on the outcome of this case may be a business reality, but it is not a justification to ignore otherwise controlling precedent.

Appellants advanced no valid argument which precludes the application of *NIPSCO* to the facts of this case.

IV. *The commission did not err in dismissing the petition without considering whether Wabash was entitled to emergency rate relief.*

Subsequent to the presentation of its case in chief to the commission, Wabash requested leave to file a supplemental or amended petition for emergency rate relief. The commission granted the request, but advised Wabash that no action would be taken on that petition until after this Court handed down its decision in *NIPSCO*. Wabash then moved for and was granted a temporary stay on its original rate increase petition, but did not file the petition for emergency rate relief, even though it had been granted leave to do so. The commission did not err in refusing to consider and rule on an

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[4] REA also advanced the proposition that a rate set by a state regulatory commission may be implicitly pre-empted by the Rural Electrification Act if the ability of the wholesale cooperative to repay its federal loan is seriously compromised, but conceded that no pre-emption question was actually before the court for consideration and determination.

issue which was never placed before it, and an appellate court will not review issues on appeal that were never before, and therefore never ruled upon, by an administrative body.

V. *The commission's dismissal of the petition did not violate Wabash's constitutional right not to have its property taken without just compensation.*

CFC contended that the commission's order violated Wabash's Fifth Amendment right not to have its property taken without just compensation. Because this issue was not raised before the commission, it was waived. We note, however, that even in the absence of waiver, it is doubtful that Wabash's creditors would have standing to raise this issue and that two courts from other jurisdictions have rejected the argument that the application of the used and useful standard for utility rates amounts to an unconstitutional taking. *See Petition of Pub. Serv. Co.* (1988), 130 N.H. 265, 539 A.2d 263; *Barasch v. Pennsylvania Pub. Util. Comm'n* (1987), 516 Pa. 142, 532 A.2d 325.

The Third District resolved the claims in this appeal in a correct manner and correctly affirmed the commission's decision. Accordingly this Court does now, pursuant to Indiana Rule of Appellate Procedure 11, order that the opinion of the Third District not be vacated or held for naught, but instead that it be and now hereby is in all respects summarily affirmed.

Summary affirmance ordered.

PIVARNIK and DICKSON, JJ., concur.

SHEPARD, C.J., dissents with opinion.

GIVAN, J., dissents. I dissent. I stand on my dissents in *Citizens Action Coal. v. No. Ind. Pub. Serv.* (1985), Ind., 485 N.E.2d 610 and *N. Ind. Pub. Serv. v. Citizens Act. Coal.* (1989), Ind., 548 N.E.2d 153.

SHEPARD, Chief Justice, dissenting.

I agree with the majority's conclusions about most of the statutory and procedural issues presented by this appeal. I do not agree, however, that the constitutional issues presented by the federal parties have been waived. Moreover, I think that these issues cannot really be resolved by issuing a simple dismissal of Wabash Valley's petition in reliance on *Citizens Action Coalition v. Northern Indiana Public Service Co.* (1985), Ind., 485 N.E.2d 610. Accordingly, I think the dismissal was erroneous.

The Utility Consumer Counselor claimed in his brief before the Court of Appeals that these issues had not been presented to the Commission. Brief of Office of the Utility Consumer Counselor at 23-24. I am satisfied that National Rural Electric adequately, though barely, preserved the constitutional questions when it resisted the Consumer Counselor's petition to dismiss by asserting that dismissal on statutory grounds would deprive Wabash Valley of rates adequate to survive a Fifth Amendment challenge. Brief of Intervenor National Rural Utilities, Record at 598, 606-609. It is apparent that this assertion presented only a Fifth Amendment takings claim and not a Fourteenth Amendment due process claim. *See generally* Shepard, *Land Use Regulation in the Rehnquist Court: The Fifth Amendment and Judicial Intervention*, 38 Cath.U.L.Rev. 847 (1989).

The parties' debate about waiver before this Court is somewhat different than it was before the Court of Appeals. National Rural Electric seeks transfer on grounds that the Court of Appeals wrongly found waiver. The Consumer Counselor and Wabash Valley Power have both chosen not to respond to this grounds for transfer. Their decision does not operate to concede the issue, but it does yield the field to National Rural Electric.

The merits of the constitutional issues cannot be adequately addressed through a motion to dismiss based on our *NIPSCO* opinion. As Justice Rehnquist has written, judicial determinations of Fifth Amendment takings claims are "essentially ad hoc, factual inquiries." *Kaiser Aetna v. United States,* 444 U.S. 164, 175, 100 S.Ct. 383, 390, 62 L.Ed.2d 332, 343 (1979). Adjudication of a claim that a regulatory scheme takes a party's property without due compensation in violation of the Fifth Amendment must necessarily be based upon a full evidentiary hearing. *Hodel v. Virginia Surface Mining & Reclamation Ass'n,* 452 U.S. 264, 101 S.Ct. 2352, 69 L.Ed.2d 1 (1981).

The rate proceeding initiated by Wabash Valley Power was suspended awaiting this Court's decision in the *NIPSCO* case. It was dismissed promptly afterwards, so there was never developed the sort of full factual record upon which the federal parties' constitutional claims could be adequately addressed. I think these parties are thus entitled to have these claims heard rather than dismissed.

My colleagues express "doubt" that the federal parties have standing to raise these questions when Wabash Valley Power does not do so. The majority does appear to recognize that because the Court rules against the fed-

eral parties on grounds of waiver, such "doubt" is not a part of the holding of today's decision. Equally entitled to speculate, I suggest that the creditors are dealing with a debtor which has little interest in seeking rates adequate to pay off. The creditors are in a posture reminiscent of the party who must call a hostile witness in order to prove his case but cannot get much cooperation on the witness stand. In circumstances like that we grant a party the right to lead the witness. I would be inclined to afford the creditors in this litigation the opportunity to present issues the debtor seems uninterested in pursuing.

# APPENDIX B

WABASH VALLEY POWER ASSOCIATION, INC.,
Plaintiff-Appellee
and
State Of Michigan And Michigan Public Service Commission, Intervening
Appellees,
v.
RURAL ELECTRIFICATION ADMINISTRATION, Defendant-Appellant.

No. 89-2482

United States Court Of Appeals,
Seventh Circuit

Argued April 3, 1990.

Decided May 23, 1990.

As Modified Aug. 22, 1990.

Before WOOD, Jr., EASTERBROOK, and MANION, Circuit Judges.

EASTERBROOK, Circuit Judge

Rate regulation for electricity rests on the theory that generating stations and transmission lines are natural monopolies. Unless constrained, suppliers charge monopoly prices in order to satisfy their investors. States hold electric utilities to the cost of service (including a competitive rate of return on invested capital); the Federal Energy Regulatory Commission does the same for whole-

sale electricity transmitted across state borders, preempting state regulation. 16 U.S.C. § 824(b); *FPC v. Southern California Edison Co.*, 376 U.S. 205, 84 S.Ct. 644, 11 L.Ed.2d 638 (1964). When the electric utility is owned by its customers, however, there is no reason to think that the seller will charge a monopoly price—or that if it does the customers will care. If the firm charges a monopoly price, the profits return to the customers as dividends, deferred rebates on the purchase price.

The natural-monopoly explanation for regulation of investor-owned utilities has been challenged. E.g., George J. Stigler & Claire Friedland, *What Can Regulators Regulate?: The Case of Electricity,* 5 J.L. & Econ. 1 (1962), reprinted in Stigler, *The Citizen and the State* 61 (1975); see also Paul L. Joskow & Richard Schmalensee, *Markets for Power: An Analysis of Electrical Utility Deregulation* (1983). For customer-owned utilities there is no equivalent debate: either way, the customers win. Most states accordingly do not regulate the prices charged by these firms. When the federal Rural Electrification Administration lends money to a utility—which it does at bargain rates for customer-owned firms—the Federal Energy Regulatory Commission drops its own system of price control, believing that customers of such firms don't need "protection" from their own managers' decisions. *Dairyland Power Cooperative*, 37 F.P.C. 12 (1967). See also *Salt River Project Agricultural Improvement & Power District v. FPC,* 391 F.2d 470 (D.C.Cir. 1968).

Yet 11 states do regulate the prices charged by cooperative electric utilities. *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983), holds that

neither the hands-off attitude of the FERC nor any generally-applicable rule established by the REA preempts state regulation. Why might states choose to regulate the prices charged by customer-owned utilities? We can think of two answers, both of which start from the premise that the equity investors (shareholders, members) of a corporation are not its sole "owners". Other persons also invest: creditors invest money in exchange for a promise interest plus repayment; employees invest specialized skills that may not be so useful at other firms. These investors obtain contractual rights. The equity investors "own" only the rights to control and profit not assigned by contract to other investors. Electric utilities commonly depend more on debt financing than on equity financing. So perhaps the "real" owners—at least the effective controllers—of an electric co-op are the debt investors, who would be tempted to raise prices past the competitive level in order to make their loans more safe or hike up the rate of interest. When creditors control the firm, they may be inclined to set a monopoly price and not rebate the profits to the equity-investor-customers. Regulation then would play the same role it does in traditional theories.

If one possibility is that regulation prevents the debt investors from exploiting the equity investors, the other possibility is that regulation enables the equity investors to exploit the debt investors. Customer-investors—residents of the state who wield political influence there—may seek regulation of "their own" utility's prices in order to depress revenues so greatly that they no longer can pay off the debt investors. They hope to emerge from bankruptcy with control of the firm and entitled to keep all future revenues for themselves. Without regulation,

the debt investors may have contractual rights to force price increases sufficient to pay the debt in full; regulation plus bankruptcy law may provide a one-two punch allowing the customer-cum-equity-investor to escape these contractual provisions yet remain in control of the utility.

Neither the customer-exploits-creditor hypothesis nor the creditor-exploits-customer hypothesis is troubling if the firm depends on a flow of fresh capital under new contracts; the need to return to capital markets frequently ensures that contractual terms are competitive, and anyone who violates commitments made then cannot be expected to be invited back. When, however, an event sufficiently large in the life of the firm or the industry occurs, it may be worth accepting the injury to one's reputation for square dealing. In this "last period", the gains from breach exceed any loss from fetters on future bargains.

## I

According to the Rural Electrification Administration, the Wabash Valley Power Association has entered that last period and is doing its best to extract the value of loans the REA made. Wabash is a non-profit generation-and-transmission utility whose customers operate in Indiana, Michigan, and Ohio. Indiana and Michigan regulate the rate customer-owned electric utilities may charge for power. Over the years the REA loaned Wabash a sum that, with unpaid interest and further advances to prevent other lenders from foreclosing, comes to about a billion dollars. Wabash promised the REA to set rates high enough to ensure that the principal and interest would be repaid. To make doubly sure, before

lending money the REA required Wabash to obtain state agencies' approval for its projects. On top of that, the REA takes a security interest in a co-op's assets, including its contracts with customers—contracts that require customers to take their requirements of electricity from the co-op at rates high enough to repay the loans. The REA thought that this combination of contractual devices would protect it. It has been proved wrong.

During the 1970s one of Wabash's neighbors, the for-profit Public Service Company of Indiana, decided to construct the Marble Hill nuclear generating station. Wabash purchased a 17% interest in the project. To finance its share it borrowed $480 million on the strength of the REA's guarantees. In January 1984 Public Service of Indiana abandoned construction of the Marble Hill station because costs had risen so high that further work would throw good money after bad. Wabash was out the money, and unless it raised its rates could not repay the lenders. It did not raise its rates and defaulted; the lenders exercised their rights under the REA's guarantees, compelling it to pay in Wabash's stead. The REA, pointing to its contract, instructed Wabash to file for rate increases sufficient to assure repayment. Wabash complied with transparent insincerity, making it clear to the state regulators that it would be delighted if they said no. (So the REA contends, and given the posture of this case we must take facts and inferences in the REA's favor. Because as a practical matter Wabash serves the interests of its owner-customers, this interpretation of its behavior before the state agencies is plausible.)

Public Service of Indiana applied for its own rate increase and emerged empty-handed. Until 1984 the

Indiana Utility Regulatory Commission believed that an investment prudent when made may be included in the rate base even though things turn out poorly. When Northern Indiana Public Service Co. (NIPSCO) applied for a rate increase to cover the expense of its abandoned Bailly N-1 plant, the Commission granted the request. *In re NIPSCO,* No. 36689 (Aug. 11, 1982). The court of appeals reversed, *Citizens Action Coalition v. NIPSCO*, 472 N.E. 2d 938 (2d Dist. 1984), affirmed, 485 N.E.2d 610 (Ind. 1985). Indiana's courts concluded that unless an investment is "used and useful" the utility is not entitled to a return on its investment. Public Service of Indiana eventually agreed not to include Marble Hill in its rate base. *In re Public Service Co. of Indiana,* No. 37414 (Mar. 7, 1986).

Such a limitation is the automatic result of competition, for a firm that builds a useless plant cannot charge more than its rivals who have invested astutely. If all firms overbuild, then there will be "ruinous competition" as price falls to marginal cost, and no one can recover the cost of capital investment. Risk of ruination makes capital more expensive (investors demand compensation for the chance that they will receive nothing). A risky business will have a higher normal rate of return on investment than a utility protected against failure by the exclusion of business rivals. So as *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 109 S.Ct. 609, 617-18 n. 7, 102 L.Ed.2d 646 (1989), observes, a policy of disallowing a return on a utility's unusable projects logically entails a higher rate of return on usable investments, and the Constitution may compel the adjustment. See also Richard J. Pierce, *The Regulatory Treatment of Mistakes in Retrospect: Cancelled Plants and Excess Capacity,* 132 U. Pa.L.Rev. 497, 525-32, 541-44 (1984).

Indiana allows its for-profit utilities to charge rates reflecting the greater risk created by the used-and-useful rule. *Citizens Action Coalition v. Public Service Company of Indiana, Inc.*, 552 N.E.2d 834 (3d Dist. 1990). For non-profit utilities the equation between greater risk (because of disallowing return on failed plants) with higher yield and greater assurance of recovery (by allowing a return on all investments prudent when made) with lower yield does not work. Because non-profit utilities are not supposed to make "profits" and do not have "equity investments" in the legal sense, the state does not allow investors any return on "investment". It asks instead only what the firm's "costs" are—wages, materials, and debt service. Excluding a failed project from the rate base means that debt investors get nothing.

When asking for a rate increase, Wabash contended that the used-and-useful rule should be applied only to for-profit utilities, which alone are entitled to return on investment. Moreover, it contended (on instructions from the REA), in a co-op the members are risk-bearers in the same sense as the investors in a for-profit firm. Consequences of mistaken decisions come home to roost in for-profit firms in lower returns on investment; for non-profits, the penalty should be visited through higher rates. The United States intervened in the administrative proceedings to drive home this contention that non-profit utilities should be treated differently. The regulatory agency disagreed and applied the used-and-useful rule across the board. *In re Wabash Valley Power Association, Inc.*, No. 37472 (Jan. 14, 1987). Wabash did not seek judicial review, but the United States did, joined by the National Rural Utilities Cooperative Finance Corporation (CFC). Both the appellate court, *CFC v. Public*

*Service Commission of Indiana*, 528 N.E.2d 95 (Ind. App. 3d Dist. 1988), and the Supreme Court of Indiana, 552 N.E.2d 23 (1990), agreed, the latter in a 3-2 decision. The majority reasoned that because co-ops were established to "provide low cost electricity to rural areas", rates should not be allowed to rise even when the owner-members are responsible for the costly blunder, *id.* at 27. Because "[a] utility may impose a charge on its ratepayers only for service", and Marble Hill provides none, "any charge purportedly imposed for service would have been inappropriate here." *Id.* at 28.

Shortly after the court of appeals rendered its decision, the REA took matters into its own hands. On November 23, 1988, the acting administrator of the REA sent Wabash a letter (copies to regulatory officials in Indiana and Michigan) asserting federal control over Wabash's rates:

> By this letter, we notify you that the REA hereby exercises jurisdiction over the rates charged by Wabash. Thus, the Indiana Commission and the Michigan Commission are no longer entitled to serve as regulatory authorities whose approval must be obtained for changes in Wabash's rates. The Commissions may retain the right to exercise jurisdiction over matters unrelated to Wabash's rates so long as Federal interests are not compromised. Wabash is hereby instructed to raise its rates 9% across the board immediately upon occurrence of any of the following events [all having to do with approval of the bankruptcy court]. Wabash shall, in addition, raise its rates 9% across the board on the first and second anniversary of the first occurrence of any event listed above. We believe that Wabash is capable of re-

> paying its debt, and calculate that the required rate increases are the minimum necessary. We are requiring phased-in rate increases rather than an immediate one-time increase to enable Wabash and its members to adjust to the higher rate level. . . . We will notify you of any different or additional rate increases to be implemented, either as part of a plan of reorganization [in bankruptcy] or otherwise.

Wabash did not put the rate increases into effect or ask the bankruptcy court for permission to do so. Instead it filed this suit, seeking a declaratory judgment that the REA lacks authority to preempt state law and exercise direct control over its rates. Michigan intervened to support Wabash; Indiana has filed papers as *amicus curiae* backing Wabash's views.

The district court granted Wabash's motion for summary judgment. 713 F.Supp. 1260 (S.D.Ind. 1989). It concluded that because formal published policies of the REA defer to state regulation, its letter to Wabash is ineffectual. *Id.* at 1266-67. Although *Arkansas* held open the possibility that state laws preventing the REA from recovering its loans might be preempted, the district court concluded that the REA's failure to argue preemption in the state litigation forecloses it from raising the subject in a separate suit. *Id.* at 1267-69.

## II

Although none of the parties has raised the question, our initial inquiry concerns federal jurisdiction. Wabash, a debtor in bankruptcy, has been told to raise its rates. The REA believes that the additional revenues will enable it to pay all of its debts and emerge prosperous.

By contrast, the plan of reorganization proposed by Wabash's members, based on the assumption that Wabash will not raise its rates, proposes to pay only about 50% of the debt to the REA, the senior secured lender. Junior creditors would get nothing, given the absolute priority rule of 11 U.S.C. § 1129(b)(2)(A). Wabash has filed this suit for the purpose of opposing the receipt of additional income. We can see why Wabash's members oppose a rate increase, but they did not sue. Wabash itself appears to be better off as a result of the REA's directive. Where is the injury in fact sufficient to create a case or controversy under Article III of the Constitution? See *Love Church v. Evanston*, 896 F.2d 1082, 1084-85 (7th Cir. 1990).

Wabash is operating as a debtor in possession. A debtor in bankruptcy is supposed to maximize the value of the estate, which opposition to a rate increase does not. This suit serves the interests of Wabash's members at the expense of the interests of Wabash's creditors. We are surprised that the bankruptcy judge has allowed Wabash to operate as debtor in possession, when the clash of interests between creditors and its current management is so obvious. Nonetheless, the REA has not asked for the appointment of a trustee, see 11 U.S.C. § 1104(a). Because the bankruptcy court has allowed Wabash to prosecute this action (no one asked the court to block the suit), we ask only whether Wabash can establish injury in fact.

Wabash argues that it may suffer two injuries. First, if it charges the rates the REA demands, state regulatory officials may require it to disgorge the proceeds and pay penalties to boot. Second, rates exceeding those authorized by state law may put Wabash in violation of con-

tracts with its members requiring them to purchase their requirements of electricity from Wabash. Freed of their commitment, these members may turn elsewhere for wholesale power (if cheaper power is to be had); the loss of business may make the price increase unprofitable. Both of these sequences are speculative. We do not know the penalties that would apply if the REA's attempt to preempt state law should fail; more, unless the states require rebates at the current interest rate, it could be profitable to collect revenues now and return them later with penalties. As for the members' willingness to turn elsewhere for power: Wabash does not represent to us that its members have wholesale power available at less than Wabash's current rates plus the increase the REA demands. Still, it is possible that such power may be available in the future, and that higher rates now may lead to losses later.

Although this is thin gruel, it is no thinner than the claim in *Duke Power Co. v. Carolina Environmental Study Group, Inc.*, 438 U.S. 59, 98 S.Ct. 2620, 57 L.Ed.2d 595 (1978), that but for a law limiting the damages that could be assessed against the operator of a nuclear plant, the plant would not be built and the risks of radiation would be reduced. The Court thought this sufficient to establish the standing of persons who live near the proposed plant, *id.* at 72-81, 98 S.Ct. at 2629-35, even though the effect of the law on construction was far from clear. (The law put a cap on liability, but the corporate form does that automatically. Firms could have established even tighter caps on liability by holding their plants as subsidiaries.) Wabash has a logical causal chain between the federal decision and potential injury. This gives it standing. There is injury in fact, and the injury is redressable by a favorable decision.

We say this cognizant that if injury befalls Wabash, the REA bears the cost. The REA is the residual claimant of the firm. Unless Wabash raises its rates, the REA stands to lose about half of its billion-dollar investment. If Wabash raises the rates only to find, because customers switch or states impose penalties, that the firm is even worse off, the REA bears the entire loss. Obviously the REA does not perceive much risk of these losses; it has no reason to compel Wabash to take steps that will reduce the realization on the debt. Still, just as we do not pierce the corporate veil to find standing in the interests of Wabash's members, cf. *In re Kubly*, 818 F.2d 643 (7th Cir. 1987), so we respect the corporate form rather than look straight to the interests of the REA. Wabash, and not the REA or its members, is the plaintiff. Wabash's exposure to loss as a result of a price increase is enough, if barely, to allow a decision by an Article III court.

Prudential concerns do not counsel dismissal. Behind the haze created by the corporate form and the bankruptcy proceedings, there is a substantial and justiciable dispute: who bears the loss of Marble Hill, the federal government or Wabash's members? Once we pass from the constitutional test to prudential concerns, it becomes significant that Wabash is acting as a tool of its members. Although a corporation technically does not "represent" its investors, many cases allow organizations to represent the interests of their members. See *Auto Workers v. Brock*, 477 U.S. 274, 281-88, 106 S.Ct. 2523, 2528-32, 91 L.Ed.2d 228 (1986). Moreover, if we were to throw the case out the sides would switch, and it would come back immediately. Wabash would refuse to raise its rates; the REA would file suit to compel it to do so, Wabash would stand on state law, and the legal questions would recur.

These questions must eventually be settled between these parties, and now is as good a time as any.

A second jurisdictional question is whether Congress has authorized a suit in the district court. Wabash contends that an agency's action is contrary to law. The Administrative Procedure Act authorizes declaratory judgment actions in such circumstances, see *Gardner v. Toilet Goods Ass'n*, 387 U.S. 167, 87 S.Ct. 1526, 18 L.Ed.2d 704 (1967), and an amendment to the APA in 1976, see 5 U.S.C. § 702, largely waives the sovereign immunity of the United States in equitable cases. *Bowen v. Massachusetts*, 487 U.S. 879, 108 S.Ct. 2722, 101 L.Ed.2d 749 (1988). The difficulty is the Tucker Act, 28 U.S.C. §§ 1346(a), 1491, which assigns to the Claims Court all actions seeking equitable relief based on a contract with the United States. Wabash contends that when it borrowed the money, the REA agreed to the application of state law. An effort to obtain specific performance of that promise (if the REA made it, a matter we do not discuss) belongs in the Claims Court. See *Sharp v. Weinberger*, 798 F.2d 1521, 1523-24 (D.C.Cir. 1986) (Scalia, J.).

In the district court the REA argued that Wabash's invocation of contractual rights required the district court to transfer the entire case to the Claims Court. The district court disagreed, holding that it may issue declaratory relief so long as that relief is not grounded in contract. 713 F. Supp. at 1263-64. We agree with that conclusion for the reasons the district judge gave. See also *Sharp*, 798 F.2d at 1524; *North Side Lumber Co. v. Block*, 753 F.2d 1482, 1486 (9th Cir. 1985). Notwithstanding its recognition of jurisdictional limits, the district court dwelt on the REA's promises to Wabash. 713 F. Supp. at 1269-70. Because any effort to obtain specific perfor-

mance of a contract with the United States belongs in the Claims Court, the district judge should not have considered Wabash's contractual claims. We put these to one side and consider only whether the arguments based on the APA support the judgment of the district court.

III

*Arkansas* holds that as a rule states may regulate the prices charged by co-ops to which the REA has extended credit. The Court mentioned two possible exceptions:

> There may come a time when the REA changes its present policy, and announces that state rate regulation of rural power cooperatives is inconsistent with federal policy. If that were to happen, and if such a rule was valid under the Rural Electrification Act, it would of course preempt any further exercise of jurisdiction by the Arkansas PSC. . . . Moreover, even without an explicit statement by the REA, a particular rate set by the Arkansas PSC may so seriously compromise important federal interests, including the ability of the [debtor] to repay its loans, as to be implicitly preempted by the Rural Electrification Act.

461 U.S. at 388-89, 103 S.Ct. at 1914-15. The REA contends that its letter of November 1988 is a change of policy and expressly preempts state law. It also contends that the rates set by Indiana and Michigan "so seriously compromise important federal interests, including the ability of the [debtor] to repay" that they are preempted implicitly. We discuss these in turn.

A

The Supreme Court did not say that the REA may preempt state law at will. It said that if the REA were to

change its policy, and "if such a rule was valid under the Rural Electrification Act", then state law must yield. There are three questions: has the REA changed its policy?; does it have substantive authority to replace state with federal regulation?; has it exercised this authority in the proper way?

At the time the Court decided *Arkansas*, language in the REA's Bulletin 111-4 recognized that states may regulate the rates of its borrowers. The language of Bull. 111-4 on which the Court relied, 461 U.S. at 387-88, 103 S.Ct. at 1914, is still in force. The REA has not yet changed its "policy", although it has attempted to force Wabash to change its rates. The REA has not established its own ratemaking apparatus or said that rates must be left to the market. Instead it has left the general rule in place and has prescribed for Wabash a rate that has nothing to do with anything except repaying the loan. This is not the sort of express preemption *Arkansas* contemplated.

There is, moreover, substantial doubt about whether a rule preempting state regulation would be "valid under the Rural Electrification Act". Neither REA's letter to Wabash nor its brief in this court cites any provision of the statute allowing it to regulate the rates charged by its borrowers. Unless the REA has this authority, it is hard to see how it can preempt state law, given the holding of *Arkansas* that federal law does not occupy the field. REA needs a source of authority to set up a system making demands inconsistent with those of state law, so that under the Supremacy Clause the federal obligation would prevail.

Congress' assumption when it created the Rural Electrification Act in 1936 seems to have been that the REA

could protect itself by setting conditions on the extension of credit. (The opinions in *Arkansas* collect the legislative history, which we do not rehearse.) The REA may refuse to make loans unless state agencies guarantee rates high enough to allow repayment. It may refuse to approve a loan unless the customers (whose promises to buy power are the real security for the debt) guarantee the loan or authorize the REA to dictate rates. If either state or customer balks, the REA may deploy its funds elsewhere. Since Indiana's adoption of the used-and-useful standard, the REA has refused to make or guarantee new loans to co-ops in that state. The conditioning power is a big club, which can achieve (effective) preemption and more. See *Trans-Alaska Pipeline Rate Cases,* 436 U.S. 631, 98 S.Ct. 2053, 56 L.Ed.2d 591 (1978). But REA did not use this power when extending credit. It approved contracts with Wabash's customers that oblige them to pay no more than the state rate; it did not secure guarantees.

We need not decide whether the REA has statutory authority to abandon Bull. 111-4 and adopt a general system of regulation. It has issued a notice of proposed rulemaking, 55 Fed.Reg. 12194 (Apr. 2, 1990), to consider thoroughgoing substitution of federal for state regulation. It would be inappropriate to interrupt that process by deciding in advance whether the REA has statutory authority. Its effort to preempt state regulation of Wabash's rates alone founders on a mundane obstacle: it neglected to use the procedures required by the APA.

In order to preempt state authority, the REA must establish rules with the force of law. Regulations adopted after notice and comment rulemaking have this effect. *Fidelity Federal Savings & Loan Ass'n v. de la Cuesta,* 458 U.S. 141, 153, 102 S.Ct. 3014, 3022, 73 L.Ed 2d 664

(1982) ("[f]ederal regulations have no less pre-emptive effect than federal statutes."). Yet although ratemaking is a "rule" under the APA, 5 U.S.C. § 551 (4), the REA did not follow the procedures the APA prescribed for rulemaking. It sent Wabash a letter. There was no notice, no opportunity for comment, no statement of basis, no administrative record, no publication in the Federal Register—none of the elements of rulemaking under the APA. 5 U.S.C. § 553. See *Thomas v. New York*, 802 F.2d 1443 (D.C. Cir. 1986) (Scalia, J.) (holding that a letter from the Administrator of the EPA does not have the force of law because it was not issued after notice and comment and was not published in the Federal Register). See also *Brock v. Cathedral Bluffs Shale Oil Co.*, 796 F.2d 533, 538 (D.C.Cir. 1986) (Scalia, J.) (rule not published in the Federal Register is not a regulation). Cf. *Cosby v. Ward*, 843 F.2d 967, 979-81 (7th Cir. 1988).

In support of its submission that a letter may preempt state law, the REA relies exclusively on *Blum v. Bacon*, 457 U.S. 132, 140-41, 102 S.Ct. 2355, 2360-61, 72 L.Ed. 2d 728 (1982). This is a baffling citation, because the case involved several regulations, published in the Federal Register after full notice and opportunity for comment. The case did not involve an informal procedure remotely similar to the one the REA followed. We have not found any case holding that a federal agency may preempt state law without either rulemaking or adjudication. Perhaps closest to the mark is a case saying that a consent decree negotiated between an auto manufacturer and the Federal Trade Commission may preempt state regulation of the manufacturer's warranty policies. *General Motors Corp. v. Abrams*, 897 F.2d 34 (2d Cir. 1990) (holding that the decree is not inconsistent with

the state's rule). The Second Circuit did not discuss *Martin v. Wilks*, ___U.S. ___, 109 S.Ct. 2180, 104 L.Ed.2d 835 (1989), which holds that a consent decree may not foreclose the rights of non-parties. Because neither the state nor the consumers were parties to the FTC's case, it is hard to understand how the decree could blot out their claims based on state law. Whether the decree has such an effect should depend on whether it was adopted by the agency as its own policy following the procedures the APA requires; then the preemption would come from substantive rules rather than the parties' assent. See *United States v. AT & T*, 552 F.Supp. 131 (D.D.C. 1982), affirmed without opinion under the name *Maryland v. United States*, 460 U.S. 1001, 103 S.Ct. 1240, 75 L.Ed.2d 472 (1983), holding that an antitrust consent decree may preempt state law when the states have had an opportunity to intervene and their contentions have been resolved on the merits. It is unnecessary to pursue the question. There has been no consent and no rulemaking. Procedural shortcomings prevent giving this letter the force of law.

B

The other string to the REA's bow is its contention that when a state sets a rate so low that the federal advance cannot be repaid, that rate is preempted. To the extent the REA believes that states must adopt rules of law that always allow federal lenders to recoup their investments, it is mistaken. See *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 99 S.Ct. 1448, 59 L.Ed.2d 711 (1979). Although obligations to federal lenders are determined under federal law, see *Kimbell* and, e.g., *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447, 456, 62 S.Ct. 676,

679, 86 L.Ed. 956 (1942), the obligation here runs from Wabash to the REA; the REA seeks to affect relations between Wabash and its customers, not relations between Wabash and the federal government. What is more, *Kimbell* holds that the federal rule governing the relation between the United States and its borrowers will be taken from state law, provided that law is not hostile to federal interests. The REA does not suggest that Indiana has depressed Wabash's rates because the federal government is its principal lender. Wabash received the same treatment as Public Service Co. of Indiana (which does not have federal loans), and under state law the REA receives the same treatment as any other lender to Wabash. The government seeks not neutrality but preference.

Its best line of argument is based on *D'Oench*, which holds that when the federal government takes over a failed bank, the relations between the bank and its customers are governed by federal law. See also *Public Service Co. of Indiana v. Hamil*, 416 F.2d 648 (7th Cir. 1969). The REA has not taken over Wabash, so the state is not trying to regulate the federal government. Yet once the debt to the REA becomes the residual claim—the one that will be paid from any new receipts—it might make sense to say that Wabash and the REA are fused. When a borrower from the federal government is far under water, regulation of it *is* regulation of the United States.

Even this analogy may not be sufficient, however, because the argument that states may not regulate the federal government comes from intergovernmental tax immunity cases. In recent years the Court has held that states may levy taxes that as a practical matter fall on the federal treasury, provided the taxation is neutral be-

tween governmental and private payors. *Washington v. United States*, 460 U.S. 536, 103 S.Ct. 1344, 75 L.Ed.2d 264 (1983); *United States v. New Mexico,* 455 U.S. 720, 102 S. Ct. 1373, 71 L.Ed.2d 580 (1982). Neutral regulation that affects the REA's coffers may be treated similarly. After all, the REA made its loans and guarantees on the assumption that state regulation would apply. Lack of guarantees from Wabash's customers—coupled with the obvious incentives of a customer-owned borrower—may have led to an adjustment in the interest rate, which, in turn, increases the rates Wabash charges. (If there was no adjustment, people at the REA were asleep on the job.) When the risk materialized, the REA has demanded shelter of federal law *plus* the interest rate that reflected the risk created by state law. Nice cushion, if you can get it.

We need not decide whether the REA is entitled to a federal rule that protects agencies that did not protect themselves. (More realistically, a rule that protects the Treasury from federal employees who neglected to take precautions and private parties who take advantage of their omissions.) Once again, we stop short of a decision on the merits because of a procedural bar. The REA was a party to the administrative proceedings and obtained review from the state courts. It did not argue that Wabash's rates should be increased because federal law preempts the used-and-useful rule or otherwise requires the state to set rates high enough to repay the loans. Its argument was based on state law. Under 28 U.S.C. § 1738 the final decision in the REA's case blocks further litigation in federal court if a state court would deem the judgment preclusive. Principles of claim preclusion apply to the United States as to other litigants. *United States*

*v. Stauffer Chemical Co.*, 464 U.S. 165, 104 S.Ct. 575, 78 L.Ed.2d 388 (1984); *Montana v. United States*, 440 U.S. 147, 99 S.Ct. 970, 59 L.Ed.2d 210 (1979). So the question is whether Indiana would allow the REA, having challenged an administrative decision in state court under state law and lost, to urge in a different suit that state law is inconsistent with federal law. We think the answer is no.

*Alleghany Corp. v. Haase*, 896 F.2d 1046, 1049 (7th Cir. 1990), assumes a negative answer to this question under Indiana law. See also *Button v. Harden*, 814 F.2d 382 (7th Cir. 1987) (Illinois law). Indiana, like most other states, does not allow a party to split a single claim for relief. Multiple legal theories supporting relief on account of one transaction must be litigated at one go. *Fischli v. Fischli*, 1 Blackford 360, 361 (Ind. 1825); *Comparet v. Hanna*, 34 Ind. 74, 77-80 (1870); *Hammond Pure Ice & Coal Co. v. Heitman*, 221 Ind. 352, 47 N.E.2d 309 (1943). We summarized Indiana's law of preclusion in *Leal v. Krajewski*, 803 F.2d 332, 334 (7th Cir. 1986), observing that claim preclusion follows from a combination of (1) a judgment rendered by a court of competent jurisdiction, (2) on the merits, (3) in a suit between the same parties, where (4) the matter now at issue was, or could have been, decided. All four elements are present here. The REA could have raised its preemption argument in state court but withheld it.

The agency reminds us that many Indiana decisions say that only matters "within the issues" of the first case—that is, subjects on which "the same evidence will support the issues involved in both actions"—are deemed precluded. E.g., *M.R. v. Meltzer*, 487 N.E.2d 836, 841 (Ind.App. 4th Dist. 1986); *Biggs v. Marsh*, 446 N.E.2d

977, 982 (Ind.App. 3d Dist. 1983). As we understood it in *Leal*, this is another way of asking whether the two suits deal with a common occurrence. Two different legal theories in support of relief (state law in the state court, preemption in federal court) do not arise out of separate occurrences, and a party who neglects to put in the evidence that would support the withheld legal theory cannot later point to its own omission as justification for filing another suit. See *Ulrich v. Drischell*, 88 Ind. 354, 359 (1882); *Jones v. American Family Mutual Insurance Co.*, 489 N.E.2d 160, 166 (Ind.App. 2d Dist. 1986); *Moxley v. Indiana National Bank*, 443 N.E.2d 374 (Ind.App. 4th Dist. 1983). Such an approach would gut the rules of preclusion. Like today's case, *Leal* deals with a suit in state court to challenge an administrative decision on state grounds, followed by a suit in federal court contesting the decision on federal grounds. We held that Indiana would deem the federal grounds foreclosed because they had been withheld in state court, when the federal grounds supplied only a different legal rationale for relief arising out of a single occurrence. The same conclusion is appropriate here.

Anticipating that we would agree with the district court's understanding of Indiana's law, the REA tries to sidestep § 1738 on the ground that it expressly told the state court that it was reserving all federal questions for federal court. It refers us to a footnote in *Haring v. Prosise*, 462 U.S. 306, 313, n. 7, 103 S.Ct. 2368, 2373 n. 7, 76 L.Ed.2d 595 (1983), reserving the question whether preclusion would be appropriate in a case under 42 U.S.C. § 1983 in which a litigant has withheld a federal question from state court. When *Haring* was decided, a debate was under way about whether § 1738 applies in

full measure to cases under § 1983. Our case does not present that question. More to the point, *Migra v. Warren City School District Board of Education*, 465 U.S. 75, 104 S.Ct. 892, 79 L.Ed.2d 56 (1984), a case the REA does not cite, resolves adversely to it even the question left open in *Haring*. See also *Village of Bolingbrook v. Citizens Utilities Co.*, 864 F.2d 481, 485 (7th Cir. 1988). Section 1738 requires the application of state law. Indiana does not allow a party to split its claim just because it has announced distinctly to the tribunal that it is going to do so.

Echoing *United States v. Michaud*, 897 F.2d 264, 267 (7th Cir. 1990), we express concern over what seems to be an emerging pattern at the Department of Justice of citing cases while not informing the court that they are no longer authoritative or do not support the proposition. The Department cites *United States v. Mendoza*, 464 U.S. 154, 104 S.Ct. 568, 78 L.Ed.2d 379 (1984), which holds that offensive non-mutual issue preclusion does not apply to the United States, while omitting *Stauffer* and *Montana*, which hold that claim preclusion applies in full force. The REA contends that because preemption is a question of federal law it is particularly appropriate for federal court, so that ordinary principles of preclusion do not apply. *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 105 S.Ct. 1327, 84 L.Ed.2d 274 (1985), which the REA does not mention in this part of its brief, is to the contrary. It contends that, despite § 1738, claim preclusion "is an equitable doctrine subject to equitable principles" (Br. 36), citing *Premier Electrical Construction Co. v. National Electrical Contractors Association, Inc.*, 814 F.2d 358, 364 (7th Cir. 1987), which does not support the proposition (it did not involve either

§ 1738 or claim preclusion), while ignoring *Federated Department Stores, Inc. v. Moitie*, 452 U.S. 394, 101 S.Ct. 2424, 69 L.Ed.2d 103 (1981), which rejects it. And as we have observed the government's brief relies (exclusively!) on *Blum v. Bacon* for the proposition that letters from federal administrators may preempt state law, although *Blum* involved formal regulations rather than letters. This is not a pattern to be welcomed.

One final potential limitation on preclusion. Indiana's courts rejected the REA's challenge to the administrative decision. Michigan has not had an opportunity to address the matter, and it is at least conceivable that Michigan would allow the United States to try again. Michigan would be bound to allow litigation on the question whether it, like Indiana, applies a used-and-useful rule in the first place to non-profit utilities. That subject was not and could not have been decided in the Indiana case. Would Michigan also let the REA argue that state law has been preempted? Perhaps. Section 1738 provides, however, that in federal court the preclusive force of a state judgment depends on its effect within the rendering state, rather than within some other state that has an interest in the controversy. At all events, none of the parties contends that Michigan would allow litigation of preemption in its courts following the omission in Indiana. We limit our reach to the subjects that have been presented.

* * *

Everything we can see about the incentives of Wabash's members and the operation of Indiana's law suggests that federal taxpayers have been taken to the cleaners. States that show creditors the door may expect

loans to be few and costly. The REA has stopped lending there. Other creditors will charge more. Indiana's economy will suffer. Indiana seeks to limit the damage through a 1987 law that abrogates the used-and-useful rule for new plants, and allows rates to be based on all prudent investment, provided the utility obtains the state commission's approval in advance. Ind.Code § 8-1-8.5.-1 et seq. If this works, Indiana will have transferred to the federal government and to other investors (most from out of state) the cost of its adventure in nuclear power, while keeping its industry healthy for the future. Creditors may be skeptical of Indiana's promise; at oral argument counsel for Michigan said that his state would feel free to repudiate such a promise if new legislators or regulators had a different view. Cf. *Chemical Bank v. Washington Public Power Supply Co.*, 102 Wash.2d 874, 691 P.2d 524 (1984). None of this matters today, for the REA lacks a sound legal basis on which to preempt Indiana's law. Appointment of a trustee in the bankruptcy court might have been the best recourse, but that is water under the bridge.

AFFIRMED.

# APPENDIX C

WABASH VALLEY POWER ASSOCIATION, INC.,
an Indiana not-for-profit corporation,
Plaintiff-Appellee,
v.
RURAL ELECTRIFICATION
ADMINISTRATION, Defendant-Appellant.

No. 91-3673

United States Court Of Appeals,
Seventh Circuit.

Argued Sept. 10, 1992
Decided March 16, 1993

Before FLAUM and RIPPLE, Circuit Judges, and SHADUR, Senior District Judge.*

FLAUM, Circuit Judge.

The history of this appeal from a grant of summary judgment against the Rural Electrification Administration ("REA") is long and unhappy. In 1978 the REA approved $360 million in loan guarantees to the power supply cooperative Wabash Valley Power Association ("Wabash Valley") to invest in a 17-percent share of the Marble Hill nuclear power facility. The Public Service Company of Indiana owned the other 83-percent share. Subsequently, the REA committed to additional guaran-

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* The Honorable Milton I. Shadur, of the Northern District of Illinois, is sitting by designation.

tees of $588 million to Wabash Valley's Marble Hill venture, for a total of $948 million in loan guarantees. To collateralize these guarantees, the REA required Wabash Valley to enter into forty-year all requirements contracts (officially labelled wholesale power contracts) with each of its distribution cooperative members. According to the terms of these contracts, the REA agreed to be bound as third-party beneficiaries to rates "subject to the approval of the Public Service Commission of Indiana."

Because of sizable cost overruns, the Public Service Company canceled the Marble Hill nuclear power facility in January of 1984. That April, Wabash Valley requested a rate increase from the Indiana Utility Regulatory Commission ("IURC")[1] in order to repay loan monies expended on Marble Hill that the REA had guaranteed. Prior to any resolution of the rate increase by the IURC, Wabash Valley defaulted on its REA loans and filed for reorganization under Chapter 11; and the REA was left holding the multi-million-dollar bag. At the time of filing, Wabash Valley had outstanding debts to the REA totalling $671 million. Subsequently, Wabash Valley's petition to the IURC for a rate hike to cover its obligations to the REA was denied. Relying on its decision in *Citizens Action Coalition v. Northern Indiana Public Service Co.*, 485 N.E.2d 610 (Ind.1985), *cert. denied*, 476 U.S. 1137, 106 S.Ct. 2239, 90 L.Ed.2d 687 (1986), the Indiana Supreme Court reiterated that the "used or useful" rule applies to customer-owned utilities and upheld the IURC's denial of Wabash Valley's request for a rate hike. *National Rural Utilities Cooperative Finance Corp. v. Public*

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[1] The Indiana Utility Regulatory Commission was formerly the Public Service Commission of Indiana.

*Service Commission of Indiana*, 528 N.E.2d 95 (Ind.App. 1988), *aff'd*, 552 N.E.2d 23 (Ind.1990).

Having failed to recoup in state court the monies extended to Wabash Valley, the REA asserted jurisdiction over ratemaking by means of a preemption letter to Wabash Valley and the IURC. The REA's letter instructed Wabash Valley to raise its rates immediately and detailed a rate schedule. We found the REA's preemption letter to be invalid because it did not comply with the notice and comment requirements of the Administrative Procedure Act. *Wabash Valley Power Association v. Rural Electrification Administration,* 903 F.2d 445 (7th Cir. 1990) ("*Wabash I*"). At the federal court level, the REA also raised the possibility of implied preemption for the first time. We held that principles of preclusion prevented the REA from asserting an implied preemption argument at that late stage of the litigation. *Id.* at 455.

While that case was still pending before this court, the REA published a notice of proposed rulemaking. 55 Fed. Reg. 12194-12202 (April 2, 1990). After the notice and comment period, the REA promulgated two new preemption regulations. 55 Fed.Reg. 38638-38654 (September 19, 1990). The first rule, concerning preemption for inadequate rates, reads in pertinent part:

> (a) State regulatory authority jurisdiction over a power supply borrower's rates shall be preempted by the RE Act if the Administrator shall have determined that the borrower's rates approved by the state regulatory authority are, after taking into account the borrower's costs and expenses, inadequate to produce revenues sufficient to permit the borrower to make required payments on its secured loans and the borrower has failed to make required payments on its secured loans.

7 C.F.R. § 1717.305 (1991). The second rule, concerning borrowers in bankruptcy, provides:

> State Regulatory Authority jurisdiction over an REA borrower's rates shall be pre-empted by the RE Act and REA shall have exclusive jurisdiction over the borrower's rates:
>
> (a) On October 19, 1990, with respect to any borrower by or against whom a case under the Bankruptcy Code of 1978, as amended, was commenced prior to and remains outstanding on October 19, 1990; and
>
> (b) With respect to all other borrowers, upon the filing of a petition by or against the borrower commencing a case under the Bankruptcy Code of 1978, as amended.

7 C.F.R. § 1717.354 (1991). Stripped of their semantic trappings, both the preemption regulations and the bankruptcy regulations are rules designed to shift the risk of default on REA loans from the REA to cooperative members. After the REA promulgated these rules, Wabash Valley brought suit in federal court for a declaratory judgment to prevent their enforcement. The district court held the rules to be invalid. We affirm.

## I.

As a federal credit program, the REA promotes and facilitates investment in electricity (and telephones, to a lesser extent) for rural areas in order to ensure that these regions receive power at reasonable prices. *See* Congressional Budget Office, *New Approaches to the Budgetary Treatment of Federal Credit Assistance* (1984); M. Weidenbaum & R. Harnish, *Government Credit Subsidies for Energy Development* (1976). It has traditionally

performed this function by reducing the cost of funding to cooperatives, as well as other nonprofit organizations, through the provision of insured loans and loan guarantees. Until recently, the Rural Electric and Telephone Revolving Fund ("RETRF"), rather than the REA itself, advanced monies for the loans and guarantees and has borne any losses incurred under the rural electrification program.[2] The RETRF, in turn, has financed its lending from repayments of principal and interest and sales of certificates of beneficial ownership to the Federal Financing Bank ("FFB").[3]

When offered at the government's cost of borrowing, loans made by the REA subsidize rural power. The interest rate the government has to pay for money is only the return on a risk-free investment. Without federal assistance, REA borrowers would have to pay a higher rate of interest to obtain insured or guaranteed loans because of the non-zero risk involved. The difference between the government's rate of interest and the rate the borrower would have otherwise had to pay is the subsidy; the cost to the government is the risk of default. In private credit

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[2] Under the Federal Credit Reform Act of 1990, the REA Revolving Fund was phased out and replaced by a Liquidating Account covering loans made before October 1, 1991. In addition, a Financing Account was established to cover funds advanced after October 1, 1991. *See* 2 U.S.C. § 661 (Supp.1992).

[3] Insured loans, which constitute a small percentage of REA credit activity, are made at a 5 percent interest rate. The lion's share of REA credit consists of loan guarantees, almost always made by the FFB, at an interest rate "not more than the rate of interest applicable to other similar loans then being made or purchases by the [FFB]." 7 U.S.C. §§ 935-36 (Supp.1992). This rate is equal to the Treasury's borrowing rate plus one-eighth of a percentage point. App. Brief at 4 n. 1.

markets, interest rates and guarantee fees incorporate a risk premium.[4] This premium both induces lenders to bear the risk of default and assures that, on average, payments by borrowers are sufficient to cover default losses. In government lending, default risk exists in at least equal measure. The cost of this risk, which is borne by taxpayers without direct compensation, is the fee that would be required to induce a lender to bear these risks. Consequently, when the guarantee program of the Rural Electrification Act, 7 U.S.C. § 901 *et seq.* (1980 & Supp. 1992) ("RE Act"), requires all REA borrowers to pay a rate of interest only marginally higher than the government's cost of borrowing (.125% higher), the rate paid by REA borrowers is substantially lower than on long-term borrowing by companies seeking credit in private markets.

Both of the current loan mechanisms of the REA reflect these subsidies. REA-insured loans contain a hidden interest subsidy representing the difference between the interest rate the borrower would obtain without REA assistance and the interest rate the government must pay for money. Moreover, the insured loans contain an explicit subsidy if the government is making insured loans at interest rates below its cost of borrowing. REA-guaranteed loans also provide both a subsidy to borrowers in the form of interest rate savings and a cost to the government in the form of risk.[5] When the chance of

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[4] The Rural Electrification Act prohibits the REA from charging a guarantee fee. 7 U.S.C. § 936 (1980).

[5] Further evidence of a policy of subsidizing rural electrification is found in the statutory provision affording the REA the

(continued...)

default by the firm is high, a guarantee can have substantial value on a large loan.[6]

Furthermore, all REA loans contain a more latent subsidy which is reflected in the amount of leverage that the REA allows its borrowers.[7] Loans to cooperatives repre-

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[5] (...continued)
discretion to lengthen the repayment period of loans and to subordinate the government's lien position in the event of default by a REA-financed cooperative. 7 U.S.C. §§ 912, 934 (1980 & Supp.1992). The existence and duration of these subsidies strongly indicate that Congress has recognized the need for the federal government to absorb some of the costs of rural electrification.

[6] The present value of a loan guarantee is the amount lenders would be willing to pay today to relieve themselves of all risk of default on an otherwise equivalent unguaranteed loan. R. Brealey and S. Myers, *Principles of Corporate Finance* 567 (1988).

[7] The favorable treatment accorded to power supply borrowers would appear to impede one of the basic goals of REA assistance—functioning without it. In a 1973 amendment to the RE Act, Congress urged that cooperatives "be encouraged and assisted to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources at reasonable rates and terms consistent with the loan applicant's ability to pay and the achievement of the Act's objectives." 7 U.S.C. § 930. However, the very structure that Congress adopted undermines the ability of cooperatives to develop other sources of financing. The extremely high leverage of power supply cooperatives makes fixed payment debt issued by such cooperatives very risky for creditors, which would lead to unusually high interest rates on that debt. *See* J. Van Horne, *Financial Management and Policy* 506 (1989). At the same time, the nonprofit status of these cooperatives prohibits them from soliciting private equity capital in order to improve their capital structure. Moreover, the policy of keeping capital
(continued...)

sent the entire investment in their property, whereas private companies must finance a large part of their investment through more costly classes of securities rather than bonds. The more leveraged a firm is, the higher the required return on the debt will be in order to attract capital. Therefore, the more leveraged the position of a rural electric cooperative, the lower the interest rate it is charged in proportion to what the market would charge.

In an world unconstrained by the RE Act, the risk in a project of the scope of Marble Hill—in conjunction with the obvious incentives of a customer-owned borrower such as Wabash Valley to charge low rates—should lead the REA to adjust the interest rate charged, which would, in turn, increase the rates Wabash Valley would charge its customers. However, the RE Act allocates to the REA and its Administrator only limited authority for effectuating the goals of the RE Act. As a consequence, the REA is obliged to rely on its financing documents—the wholesale power contract, the loan contract, and the security instrument—to condition repayment and thereby protect itself.

II.

As we indicated in our previous decision, customer-owned utilities can function as self-regulating entities because they have no incentive to charge excessive rates for the electricity they sell. *Wabash I*, 903 F.2d at 447. Therefore, REA-financed cooperatives do not require pro-

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[7] (...continued)
contributions by distribution cooperative members to a minimum forecloses another avenue of improving their capital structure.

tection against their own managers' decisions. Despite the incentives provided by the structure and operation of the RE Act, however, borrowers do not have unfettered discretion. The REA itself exercises control over all of its borrowers through the imposition of contractual requirements (and not through the explicit regulation of electricity rates). In addition, eleven states also regulate prices charged by their cooperative electric utilities. In these states the REA makes its loans and guarantees with the knowledge that state regulation applies.[8]

The relationship among the power supply cooperatives, distribution cooperatives, and the REA is structured through the wholesale power contract. This contract obligates a distribution cooperative to purchase all of its electric power over a fixed term (in this instance, forty years) from a power supply cooperative. When lending money to the power supply cooperatives, the REA requires that they enter into wholesale power contracts with member distribution cooperatives. (Likewise, when entering into such relationships with distribution cooperatives, the REA requires those distribution cooperatives to enter into similar contracts with power supply cooperatives.) This arrangement ensures that power supply borrowers will be able to earn revenue from the sale of

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[8] For example, the language of Wabash Valley's mortgage agreement repeats the more general language of standard REA mortgages, which provide that cooperative rates would be "subject to applicable laws and rules and orders of regulatory bodies." According to *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n*, 461 U.S. 375, 388, 103 S.Ct. 1905, 1914, 76 L.Ed.2d 1 (1983), "any reference in an REA document to a 'regulatory commission' could only mean a state regulatory agency."

power sufficient to meet their costs. One level of protection is the security interest the REA takes in the physical assets of both types of cooperatives as well as in the respective rights and interests of each party under the wholesale power contracts.

In addition to taking a security interest in the assets of the power supply cooperative, including the wholesale power contracts, the REA requires a power supply borrower, such as Wabash Valley, to obtain the approval of state regulatory agencies for its investment projects before lending any money. Within this system of supervision, the wholesale power contracts themselves constitute the lynchpin of the REA lending program. A state regulatory agency that sets cooperative utility rates too low would frustrate the effectiveness of the wholesale power contracts. As a result, the REA contends that ratemaking by state regulatory agencies which seriously compromises the ability of REA borrowers to make required payments is subject to preemption.

A.

When the federal government acts within its constitutional authority, it is empowered to preempt state laws to the extent it believes such action to be necessary to achieve its purposes. The Supremacy Clause of the Constitution authorizes this federal action, and the phrase "Laws of the United States" of Article IV encompasses both federal statutes themselves and federal regulations that are properly adopted in accordance with statutory authorization. For this reason, the Supreme Court has not only established a number of ways in which Congress can be understood to have preempted state law, *see*

*Louisiana Public Service Comm'n v. F.C.C.*, 476 U.S. 355, 368-69, 106 S.Ct. 1890, 1898-99, 90 L.Ed.2d 369 (1986), but the Court has also recognized that "a federal agency acting within the scope of its congressionally delegated authority may pre-empt state regulation." *Id.* at 369, 106 S.Ct. at 1898-99.

In order for the REA to enforce its preemption regulations, it must overcome two significant obstacles. The first hurdle is the longstanding presumption against preemption of an area traditionally subject to state regulation. *See California v. ARC American Corp.*, 490 U.S. 93, 100, 109 S.Ct. 1661, 1665, 104 L.Ed.2d 86 (1989). When regulation is of a field traditionally occupied by the states, "we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 231, 67 S.Ct. 1146, 1152, 91 L.Ed. 1447 (1947). The same principle applies when an agency acts to preempt the field. *Hillsborough County v. Automated Medical Laboratories, Inc.*, 471 U.S. 707, 715, 105 S.Ct. 2371, 2376, 85 L.Ed.2d 714 (1985). More than fifty years of state regulation of cooperative utility rates (in those states that have continued to regulate these rates) since the enactment of the RE Act certainly reflects the fact that Congress has not occupied the field. Therefore, the REA must demonstrate a conflict between state regulation of cooperatives and the federal rural electrification program that is strong enough to overcome the presumption that state ratemaking can constitutionally coexist with the federal financing regime.

The second obstacle in the REA's path is the scope of the agency's authority in rulemaking. Legal authoriza-

tion for preemptive federal regulations follows from two fundamental precepts. "First, an agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign State, unless and until Congress confers power upon it. Second, the best way of determining whether Congress intended the regulations of an administrative agency to displace state law is to examine the nature and scope of the authority granted by Congress to the agency." *Louisiana Public Service Comm'n*, 476 U.S. at 374, 106 S.Ct. at 1901. Under the very deferential standard of review enunciated by the Supreme Court, our inquiry is whether a federal agency has properly exercised its own delegated authority rather than simply whether Congress has properly exercised its legislative power. Thus, in determining when state law is pre-empted by federal regulation, a "narrow focus on Congress' intent to supersede state law [is] misdirected" because "[a] preemptive regulation's force does not depend on express congressional authorization to displace state law." *Fidelity Federal Savings & Loan Assn. v. De la Cuesta*, 458 U.S. 141, 154, 102 S.Ct. 3014, 3023, 73 L.Ed.2d 664 (1982). If authorized by statute, the regulations of an agency will preempt state law that conflicts with such regulations or frustrates the purpose of those regulations. *City of New York v. F.C.C.*, 486 U.S. 57, 64, 108 S.Ct. 1637, 1642, 100 L.Ed.2d 48 (1988); *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 104 S.Ct. 2694, 81 L.Ed.2d 580 (1984).

B.

Much of the discussion—and disagreement—over the REA's authority to preempt turns on the single Supreme

Court decision in this area. *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n,* 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983), established that, as a rule, states may regulate electricity prices charged by cooperatives that have received credit from the REA. However, the Supreme Court identified two potential exceptions:

> There may come a time when the REA changes its present policy, and announces that state rate regulation of rural power cooperatives is inconsistent with federal policy. If that were to happen, and if such a rule was valid under the Rural Electrification Act, it would of course preempt any further exercise of jurisdiction by the [state regulatory authority] . . . . Moreover, even without an explicit statement by the REA, a particular rate set by the [state regulatory authority] may so seriously compromise important federal interests, including the ability of the [cooperative] to repay its loans, as to be implicitly preempted by the Rural Electrification Act.

*Id.* at 388-89, 103 S.Ct. 1915. Earlier in this protracted litigation, the REA forwent the chance to press the second exception, which may have been its strongest argument. When originally proceeding in Indiana to recover its investment, the REA, for reasons that are not clear to us, did not raise the possibility of implied preemption. Having failed to raise the implied preemption argument in the administrative and judicial proceedings in Indiana, the REA was prevented by principles of preclusion from attempting to do so in federal court. *Wabash I,* 903 F.2d at 455. When this avenue was foreclosed in the previous litigation, the REA enacted the two new

regulations.[9] Although the REA does not directly attempt an implied preemption argument in this appeal, the agency relies on the relevant language in *Arkansas Electric* to reinforce its assertion of statutory authority to preempt state utility regulation. In response, Wabash Valley contends that res judicata effectively prohibits the REA from relying on implied preemption, particularly if the intent of its rulemaking is to circumvent our earlier holding.

Res judicata, and its paternal twin collateral estoppel, have been the subject of widespread discussion in numerous cases. *See, e.g., United States v. Mendoza*, 464 U.S. 154, 157-59, 104 S.Ct. 568, 571, 78 L.Ed.2d 379 (1984); *Federated Dep't Stores, Inc. v. Moitie*, 452 U.S. 394, 398, 101 S.Ct. 2424, 2427, 69 L.Ed.2d 103 (1981); *Allen v. McCurry*, 449 U.S. 90, 101 S.Ct. 411, 66 L.Ed.2d 308 (1980); *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326, 99 S.Ct. 645, 649, 58 L.Ed.2d 552 (1979); *Smith v. City of Chicago*, 820 F.2d 916 (7th Cir.1987). According to the Supreme Court, res judicata prevents a party "from relitigating the same cause of action against the parties to a prior decision." *Mendoza*, 464 U.S. at 163, 104 S.Ct. at 574. More illuminating, the Fifth Circuit has elaborated that res judicata "treats a judgment, once rendered, as the full measure of relief to be accorded between the same parties on the same 'claim' or 'cause of action.' . . .

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[9] The concurrence regards our conclusion that the REA missed its chance to press the implied preemption argument held out by the Supreme Court in *Arkansas Electric* as silence. In fact, that language suggests a possible recourse for the REA absent specific regulatory action. Once the REA enacted the preemption regulations—its explicit statement, we naturally turn to its authority to do so.

Under these rules of claim preclusion, the effect of a judgment extends to the litigation of all issues relevant to the same claim between the same parties, whether or not raised at trial." *Kaspar Wire Works, Inc. v. Leco Engineering & Machinery, Inc.*, 575 F.2d 530, 535-36 (5th Cir.1978).

Because this litigation originated in Indiana, its rules of preclusion determine whether res judicata bars the REA from applying its regulations to the REA. *See Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 105 S.Ct. 1327, 84 L.Ed.2d 274 (1985); *see generally Hart and Wechsler's The Federal Courts and the Federal System*, 1627-29 (3d ed. 1988). According to Indiana law, which we summarized in *Leal v. Krajewski*, 803 F.2d 332, 334 (7th Cir.1986), claim preclusion follows from the following four factors: (1) a judgment from a court of competent jurisdiction, (2) on the merits, (3) in a suit between the same parties, in which (4) the matter at issue was, or might have been, determined in the former suit. Rather than a claim or a cause of action, therefore, we are left to decide whether there is a coincidence in the matter at issue in this and the previous litigation.

Indiana's formulation for what constitutes a matter at issue is more narrow than our federal rule, under which a single cause of action consists of " 'a core of operative facts' which give rise to a remedy," *In re Matter of Energy Cooperative, Inc.*, 814 F.2d 1226, 1230-31 (7th Cir.), *cert. denied*, 484 U.S. 928, 108 S.Ct. 294, 98 L.Ed.2d 254 (1987) (quoting *Car Carriers, Inc. v. Ford Motor Co.*, 789 F.2d 589, 593 (7th Cir.1986)). For purposes of claim preclusion, "[e]very [matter] which was within the issues, and which, under the issues, might have been proved,

will be presumed to have been proved and adjudicated." *Peterson v. Culver Educational Foundation,* 402 N.E.2d 448, 460 (Ind.App.1980) (quoting *Town of Flora v. Indiana Service Corporation,* 222 Ind. 253, 53 N.E.2d 161 (1944)); *see Yellow Cab Co. v. Williams*, 583 N.E.2d 774, 777-79 (Ind.App.1991); *M.R. v. Meltzer*, 487 N.E.2d 836, 841 (Ind.App.1986); *Biggs v. Marsh*, 446 N.E.2d 977, 982 (Ind.App.1983). As we recognized in *Wabash I*, the inquiry under Indiana law is essentially whether the two suits deal with a common transaction or occurrence. 903 F.2d at 456. Under this conceptualization, a very expansive construction of Indiana's rule of res judicata might conceivably extend to the REA's attempt to apply the preemption regulations to Wabash Valley.

The procedural posture of the litigation substantially complicates this analysis. At one level, it does appear that the REA has resorted to rulemaking in order to avoid the impact of our earlier holding. The REA nevertheless maintains that its authority to expressly preempt particular state rates can be implied from the RE Act itself. Arguably, the fact that the REA has waived implied preemption with respect to Wabash Valley would militate in favor of finding that res judicata bars the application of these regulations—which are themselves derived from implied authority—to Wabash Valley. It would follow that to the extent that the REA is relying on implied preemption, our earlier decision has foreclosed any revisiting of that issue.

However, this reasoning is flawed in two important respects. First, the REA's argument is not simply one founded on the principle of implied preemption. It is asserting the implied authority to engage in preemptive rulemaking rather than the authority to impliedly pre-

empt. In this regard, the REA asserts that its regulations are compatible with the statutory responsibilities delegated by the RE Act to the Administrator of the REA. Second, the matter at issue for purposes of Indiana law are regulations that could not have been the subject of the preceding litigation because they were not in existence. While the timing and rationale of the preemption regulations may be suspect, that alone is not sufficient to bring the use of those regulations against Wabash Valley within the principles of res judicata. Such a conclusion would be an unwarranted distortion of the posture of the litigants in *Wabash I* and the Indiana rules of preclusion.[10]

III.

The fact that res judicata does not bar this suit does not relieve the REA of the need to establish the validity of the regulations themselves. According to the standard

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[10] Under the concurrence's singular notion of preclusion, the REA apparently can no longer rely on federal law to overcome Indiana's regulation of Wabash Valley's rates. This approach to claim preclusion lavishes attention on the potential outcome of the REA's actions at the expense of identifying the *claim*—in the sense of the cause of action. In defining the scope of claim preclusion (and not issue preclusion, which is irrelevant to a subsequent suit between the parties to an earlier action), our ultimate source is the Indiana courts. When other facts or conditions intervene, forming a new basis for a claim, claim preclusion does not apply. *Cf. South Bend Federation of Teachers v. National Education Ass'n,* 180 Ind.App. 299, 389 N.E.2d 23, 34-35 (1979). Accordingly, the issue of resorting to implied preemption was put to rest in our previous opinion. Enforcement of the preemption regulations was not. It is axiomatic that the reach of claim preclusion extends only to those theories which could have been raised in the earlier proceeding.

expressed in *Arkansas Electric*, state law would be expressly preempted if the REA were to change its policy and "if such a rule were valid under the Rural Electrification Act." 461 U.S. at 389, 103 S.Ct. at 1915. Prior to the enactment of these regulations, the published policy of the REA required borrowers to "submit proposed rate changes to any regulatory commissions having jurisdiction and [to] seek approval in the manner prescribed by those commissions." REA Bulletin 111-4 at 1-2 (1972) (quoted in *Arkansas Electric,* 461 U.S. at 387, 103 S.Ct. at 1914). Preemption of state regulatory jurisdiction would have been wholly inconsistent with the REA's own guidelines. The new preemption regulations—which apply not only to Wabash Valley but to all REA-financed cooperatives—manifests a change in policy. While not denying states the authority to regulate rates charged by cooperatives, the REA has attempted to carve out specific exceptions to this general rule. 7 C.F.R. §§ 1717.300-310, 1717.350-356 (1991). Our principal inquiry, therefore, is whether Congress intended for the REA to exercise such preemption power.[11]

A.

Because Congress has not occupied the field, the REA must establish some other statutory basis for the new regulations. To this end, the REA argues that the fun-

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[11] A subsidiary consideration is whether the REA has lawfully exercised properly delegated power. Provided that statutory authorization exists, regulations adopted pursuant to notice and comment rulemaking constitutes a lawful exercise of that power. *Batterton v. Francis*, 432 U.S. 416, 419 n. 9, 97 S.Ct. 2399, 2405 n. 9, 53 L.Ed.2d 448 (1977).

damental purpose underlying the RE Act is that loans be repaid. Authority for this assertion derives from the Act itself, which provides that loans "shall not be made unless the Administrator finds and certifies that in his judgment the security therefor is reasonably adequate and such loan will be repaid within the time agreed." 7 U.S.C. § 904. If the Administrator finds that the loan "will be repaid," then the loan is authorized by statute, at the statutorily-fixed interest rate. *Id.* If the loan will not be repaid, then the REA is prohibited from making the loan.

Standard wholesale power contracts entered into by REA borrowers and distribution cooperative customers, which determine the stream of revenues, represent the principal security for an REA loan or guarantee. A borrower's revenues from its sales of electricity will constitute adequate security to ensure repayment of a loan only if the borrower is in a position to sell a sufficiently large quantity of electricity at a sufficiently high price. The REA contends that it is implausible to construe the REA's loan documents to require borrowers to design their rate structures in a manner that generates sufficient revenues to enable loan repayment, yet at the same time to empower state regulatory agencies to disapprove rates that are necessary for a borrower to generate revenues required to meet repayment schedules. 55 Fed.Reg. 38641. If state regulatory agencies can impair repayment through the imposition of inadequate rates, the argument goes, those agencies may jeopardize the viability of the rural electrification program.

In order to prevent this outcome, the REA now seeks to formalize its authority over utility rates of power supply cooperatives through its proposed rules for preempt-

ing, on an ad hoc basis, state regulation in general ratemaking and for bankruptcy proceedings. Subject to the parameters of the statute, the proposed rules would represent a valid exercise of express preemptive authority if they serve an important federal interest. According to the REA, the important federal interest at stake consists solely of the repayment of the federal loans. In reviewing the validity of these regulations, this court does utilize the deferential standard that the REA urges. *City of New York*, 486 U.S. at 64, 108 S.Ct. at 1642; *De la Cuesta*, 458 U.S. at 154, 102 S.Ct. at 3023. However, in applying this deferential standard, we must take account for two significant factors.

First, the statute itself is silent with respect to rulemaking by the REA. Unlike the cases on which the REA relies for the deferential standard of review, the RE Act itself does not contain any general delegations of discretionary power to the Administrator. *E.g., City of New York*, 486 U.S. at 67-68, 108 S.Ct. at 1643-44 (Commissioner may "[m]ake such rules and regulations and prescribe such restrictions, not inconsistent with law, as may be necessary to carry out the provisions of this chapter") (quoting 47 U.S.C. § 303); *De la Cuesta*, 458 U.S. at 160, 102 S.Ct. at 3026 (Federal Home Loan Bank Board may issue regulations "to provide for the organization, incorporation, examination, operation, and regulation of [savings and loan] associations.") (quoting 12 U.S.C. § 1464(a)(1)); *see also Chrysler Corp. v. Brown*, 441 U.S. 281, 308-09, 99 S.Ct. 1705, 1721, 60 L.Ed.2d 208 (1979). To argue that Congress did not intend for states to frustrate the goals of the RE Act falls short of establishing a statutory basis for the REA's sweeping assumption of regulatory authority over ratemaking for

cooperatives.[12] Any authority exercisable by the REA is merely derivative of the Administrator's responsibilities for the operation of the loan and guarantee programs under the RE Act. *See, e.g., Public Utility Dist. No. 1 v. Big Bend Elec. Cooperative, Inc.*, 618 F.2d 601 (9th Cir. 1980).

Moreover, to extract a single phrase from a comprehensive legislative scheme and christen it as the defining characteristic does not comport with the spirit of the statute or its history. *See* 7 U.S.C. §§ 902, 930. Because the opinions in *Arkansas Electric* detail the legislative history of the RE Act, we will not repeat that here. *See Arkansas Electric*, 461 U.S. at 386-88, 398-401; 103 S.Ct. at 1913-14, 1920-21. Certainly, the purpose of the RE Act cannot be reduced to a single overriding concern for the welfare of the federal Treasury. Rural electrification, whether enabling electricity purchases by distribution cooperative customers or assisting the development of generation and transmission facilities, remains the fundamental goal of the RE Act. Continued congressional willingness to subsidize rural power development confirms this conclusion. We are not persuaded that national rules for rate regulation of rural electric cooperatives,

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[12] The wholesale power contracts underlying the REA's argument do serve to define the relationship among the power supply cooperative, the distribution cooperatives, and the REA; consequently, such a contract would allow the REA, for example, to enforce its rights as a third-party beneficiary of the revenue stream. *See Tri-State Generation & Trans. Ass'n v. Shoshone River Power, Inc.*, 874 F.2d 1346, 1359-60 (10th Cir. 1989). However, these contracts are not so strong as to bear the weight of a system of utility regulation that the REA proposes.

administered on an ad hoc basis, is the answer to safeguard the viability of the rural electrification program itself or to protect the Treasury from defaulting borrowers. *Cf. United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 729, 99 S.Ct. 1448, 1459, 59 L.Ed.2d 711 (1979).

Second, the presumption against preemption reinforces our conclusion that nondiscriminatory state regulation which fosters legitimate state interests should not be subject to preemption in the manner that the REA now proposes. In denying the rate hike to Wabash Valley early in this litigation, the Indiana authorities acted in accordance with longstanding principles of utility rate regulation. We do not find that the federal interest in recovering its monies is sufficiently strong to upset the tradition of shared state and federal responsibility over the utility rates of REA-financed cooperatives. Although preemption regulations may be an adequate regulatory response to similar circumstances in the future, Congress has not embraced the regulatory approach in the original statute or its amendments. *Cf. Securities Industry Ass'n v. Board of Governors of Federal Reserve System,* 468 U.S. 137, 153-54, 104 S.Ct. 2979, 2988, 82 L.Ed.2d 107 (1984). This fact, as well as sustained congressional subsidization of rural electrification, indicate that the REA would need to show state action that is more drastic or even discriminatory before federal preemption is warranted. Allowing the Administrator to vitiate particular state rates set according to long-established principles of ratemaking is not compatible with this statutory scheme.

Being a lending agency administering a federal credit program rather than a regulatory agency, the REA has at its disposal means to secure repayment that are less disruptive to the recognized prerogative of states to regu-

late cooperative utility rates. *See* 55 Fed.Reg. 38641. Because interest rates on RE Act insured and guaranteed loans are fixed by statute, 7 U.S.C. §§ 935-36, the REA—unlike an ordinary commercial lender—does not have the option of making a loan at an enhanced interest rate to compensate for the perceived risk of default. Instead, the REA has the stick of its authority to lend or not to lend in a particular jurisdiction to protect against defaulting debtors. In fact, the RE Act appears to reflect an assumption by Congress when it created the Rural Electrification Administration that the REA could protect itself by setting conditions on the extension of credit.

Under the RE Act, the REA finances power-supply borrowers only with the required approvals of all state regulatory authorities. 7 U.S.C. § 904; 55 Fed.Reg. at 38654. Accordingly, if a state, in its discretion, declines to approve a proposed loan, then the RE Act does not permit the loan to be made. On the other hand, if the state gives its approval, then the loan is authorized subject to the "terms and conditions" imposed by the Administrator. 7 U.S.C. § 904. As a term or condition, the REA may refuse to make loans unless state regulatory authorities formally commit to rates high enough to allow repayment. The REA may similarly refuse to approve a loan unless the customers, whose promise to buy power are the real security for the debt, guarantee the loan or authorize the REA to oversee rates. If either the state or the cooperative customer balks, the REA may deploy its funds elsewhere.[13] Thus, the REA conditions power supply loans on

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[13] The strength of this stick should not be underestimated. After the financial difficulties with Wabash Valley, the REA

(continued...)

state commitments to set wholesale power rates high enough to enable loan repayment. The REA failed to so qualify its loan guarantees to Wabash Valley.

B.

Distilled to its essence, the REA would have Wabash Valley's subscribers absorb the losses stemming from Wabash Valley's default and the REA's mishandling of its security arrangement. While the monies disbursed through the REA are properly regarded as credit rather than grants, the tools in the REA's kit to ensure repayment are not without limits. As with any other lender, the REA assumes the business risk of advancing money to a specific organization, the risk that the organization will not be able to repay. Given the history and function of the RE Act, the scope of this risk incorporates the possibility that state regulation may occasionally impede the ability of power supply cooperatives to repay their loans. One could reasonably argue that the structure and operation of the subsidies provided through the REA reflect a congressional preference for the government's bearing this risk, rather than cooperative members. In any event, it is clear that the REA may not dictate who shall bear the risk because that would amount to the agency conferring power on itself. *Cf. Louisiana Public Service Comm'n*, 476 U.S. at 374, 106 S.Ct. at 1902. The REA has not identified a source of authority in either the express language or the purpose and operation of the RE

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[13] (...continued)
suspended its lending in Indiana. Subsequently, the Indiana legislature amended its "used or useful" standard to accommodate specifically the repayment of obligations to the REA. *See* Ind.Code Ann. § 8-1-17-20 (West Supp.1992).

Act to justify its preemption regulations. Accordingly, we cannot infer that the statute grants the Administrator the authority he seeks.

For the foregoing reasons, the decision of the district court is AFFIRMED.

SHADUR, Senior District Judge, concurring in the result.

Judge Flaum's opinion provides an admirably clear exposition of an extremely complex subject matter, especially overlaid as that subject matter is in this case by a tortuous history of repeated litigation. And the result—REA's inability to enforce its 1990 preemption regulation against Wabash Valley—is equally unexceptionable. Where I must regretfully part company with the majority is in its having gone beyond that issue to one that I believe to be unnecessary to the decision: the validity or invalidity of the preemption regulation on its face (that is, whether the regulation is potentially viable against REA borrowers other than Wabash Valley under circumstances other than the unique set of facts in this case).

Not only is that added reach of the opinion unnecessary to the resolution of the two-party controversy before us, but it also seems to me that:

> 1. Invalidation of the regulation on its face, rather than simply as sought to be applied against Wabash Valley, is at odds with the sound jurisprudential approach counseled by Justice Brandeis in his famous concurrence in another power case—*Ashwander v. TVA*, 297 U.S. 288, 346-48, 56 S.Ct. 466, 482-83, 80 L.Ed. 688 (1936).

> Even though *Ashwander* dealt with the wisdom of avoiding constitutional questions as to Congress' legislative power unless those questions had to be reached to decide the particular case, I believe that the same notion of judicial restraint should extend to our not deciding on the general power of an administrative agency to "legislate," where resolving that question is equally nonessential to the current decision.
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> 2. Invalidation of the regulation also gives insufficient credence to one of the prospects for implied preemption specifically held out by the Supreme Court in *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 389, 103 S.Ct. 1905, 1915, 76 L.Ed.2d 1 (1983). To be sure, that statement is dictum. But just as district judges are expected to pay heed to dicta from their Courts of Appeals—at least in situations where there is no need to evaluate the force (or lack of force) of such dicta in order to decide the specific case at issue—so the basic concept of our judicial hierarchy calls for Courts of Appeals to approach Supreme Court dicta in the same gingerly fashion.

Although no extended discussion is required to explain those points of departure from the majority opinion, a brief explanation is certainly in order.

First, REA must lose this case under established principles of claim preclusion. My principal reason for generally preferring the terms "claim preclusion" and "issue preclusion" over the more traditional "res judicata" and "collateral estoppel" terminology is to avoid any confusion that might stem from the fact that "res judicata" is often used as the generic term for *both* branches of preclusion stemming from prior litigation (see Justice Blackmun's

opinion for the Court in *Migra v. Warren City School Dist. Bd. of Educ.*, 465 U.S. 75, 77 n. 1, 104 S.Ct. 892, 894 n. 1, 79 L.Ed.2d 56 (1984)). In this instance, though, the contrasting "claim preclusion" versus "issue preclusion" usage also serves to highlight the reason that Wabash Valley should prevail here on the former ground.

REA's *claim* before us is the same claim that it eschewed asserting against Wabash Valley in the original Indiana litigation between them, and that we therefore barred it from advancing on claim preclusion grounds in *Wabash I,* 903 F.2d at 455: the claim that federal law preempts the Indiana regulation because it has set too low a rate. In *Wabash I* we scotched REA's attempted use of an agency letter as the means by which it sought to preempt state law. Even though REA now seeks to place that old wine into the new bottle of a regulation, its legal *claim* of implied preemption is no different than before. REA is no more entitled to litigate that claim, having foregone the opportunity to do so in the prior litigation between the same parties, than any losing plaintiff in any other lawsuit is free to assert the same claim a second time around by developing another legal theory for holding the defendant liable.

Thus the majority opinion's parsing of REA's current argument as one "asserting the implied authority to engage in preemptive rulemaking rather than the authority to impliedly preempt" (at 1488) gives REA more than its due. That type of distinction is one without a difference for claim preclusion purposes—it is fundamental to claim preclusion, in contrast to issue preclusion, that the former bars not only every issue that *was* urged by the losing party but also every issue that *could have been* urged in support of its position (*Leal v. Krajewski*, 803

F.2d 332, 334-35 (7th Cir.1986) (applying Indiana law)). Indeed, the majority's stated distinction could readily be paraphrased to give every disgruntled litigant a second bite at the apple in another lawsuit, by the mere device of its dreaming up a fresh theory that it did not tender to the court the first time around.

Hence REA must lose on its implied preemption claim as against Wabash Valley, because it has already had its day in court and it then chose not to argue that *claim* (as we held in *Wabash I*, 903 F.2d at 455). And that leads to my second point of departure from the majority opinion, which—despite its having quoted *Arkansas Electric* and that opinion's *two* potential bases for preemption (at 1486)—then avoids any discussion of the second of those bases for the entire balance of the text (at 1488-91) that follows the res judicata discussion.

To repeat, here is the second prospect held out in *Arkansas Electric*, 461 U.S. at 389, 103 S.Ct. at 1915:

> Moreover, even without an explicit statement by the REA, a particular rate set by the [state regulatory authority] may so seriously compromise important federal interests, including the ability of the [cooperative] to repay its loans, as to be implicitly preempted by the Rural Electrification Act.

We cannot fairly gloss over such a statement by the Supreme Court by being silent about it. That language unquestionably holds out the possibility of implied preemption of state rates *without* any need to identify a specific source in the Rural Electrification Act (unlike *Arkansas Electric*'s first potential exception, which occupies the entire substantive discussion at pages 1488-91 of the majority opinion here).

To be sure, the just-quoted statement from the ultimate judicial source (though concededly via dictum) leaves all of its readers—courts, administrative agencies, lawyers—with the task of divination, a process that has occupied lesser mortals at least since the Delphic Oracle began to issue its pronouncements. And REA has now engaged in that process: It reads that language as permitting it to issue a regulation to announce the rule that it would contemplate applying in future situations where state regulatory authority has "seriously compromise[d] important federal interests, including the ability of the [cooperative] to repay its loans."

It appears from footnote 10 to the majority opinion that I may not have made the difficulty that I find with the approach taken there entirely clear. At the risk of repetition, let me summarize briefly. REA itself has not pointed to any express authority in the Rural Electrification Act for promulgation of its preemption regulation, and Judge Flaum has painstakingly and persuasively demonstrated that no such express statutory authority exists. Hence I believe that REA must seek to prevail here—if it can—only on the ground that implied preemption is available on the basis that I have just set out: that the regulation does no more than to announce the prospect of the kind of preemption held out as a possibility by the *Arkansas Electric* statement that I have quoted. And *that* argument was indeed available to REA, but was not made by it, in the earlier litigation. That was therefore a matter that *could have been* urged and determined in the first litigation—and, as already stated, that is the test for claim preclusion in Indiana (as everywhere).

In that view, it does not serve any useful purpose (and indeed I would suggest that it undercuts sound jurisprudential principles) for this Court to decide two issues that it need not resolve in order to rule against REA in light of the litigation history here:

> 1. whether the prospect of implied preemption is indeed held out as a possibility by what the Supreme Court said in *Arkansas Electric*, and
>
> 2. whether a regulation—essentially an agency's advance announcement of the existence of such a possibility and of the general principles that will govern its exercise—is an appropriate way to apprise the legal community of REA's position in those respects.

If both of those questions merit an affirmative answer, then the regulation is valid despite its lack of grounding in express statutory authorization. But those questions are better left for decision by a court in the future if, at some later date, REA were to apply that new regulation to a concrete case involving an inadequate rate approved by a state agency in the face of the preemption regulation (a *very* different situation from the one that we confront here).

Accordingly, although I agree entirely with the emptiness of REA's position in this case because it has forfeited its right to argue implied preemption against Wabash Valley, I regret that I cannot subscribe to a decision that forecloses REA from taking the Supreme Court at its word in dealing in the future with others who are not parties to this litigation, in circumstances where REA has not tied its own hands as it has against Wabash Valley. For the reasons stated here, I concur in the result reached by the majority but not in its rationale for arriving at that result.